

**THE DUTIES, RESPONSIBILITIES
AND LIABILITIES OF BANK
DIRECTORS**



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The Duties, Responsibilities and Liabilities of Bank Directors

BY

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OF ARKANSAS

New York

THE MACMILLAN COMPANY

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TO MY FATHER
ROBERT E. MAJOR
WHO HAS FOR OVER THIRTY YEARS
BEEN A COUNTRY BANKER
AND MY MOTHER
SARAH A. MAJOR
WHO IS A COUNTRY BANK DIRECTOR
THIS BOOK IS AFFECTIONATELY DEDICATED

PREFACE

During nearly seven years with the State Banking Department of Arkansas, first as bank examiner and then as Assistant Bank Commissioner, the author has seen how little bank directors realize their duties, responsibilities and liabilities.

The purpose of this volume is to give in a concise way, avoiding as far as possible technicalities, information and suggestions which will be helpful to bank directors in fulfilling that trust which is imposed in them when they are elected by the stockholders to govern and direct the policies of a bank.

In this volume no distinction is made between State Banks, National Banks, Savings Banks and Trust Companies. No attempt has been made to point out the differences in the various kinds of banking institutions, but all have been taken as "Banks" and the duties, responsibilities and liabilities of "Bank Directors" discussed in the broadest way.

It is hoped that this work will prove constructive and that many helpful suggestions may be received by all who read it, but it is especially written for the "country bank" director.

F. L. M.

CONTENTS

	PAGE
CHAPTER ONE. THE BANKING BUSINESS	1
How banks differ from other business enterprises; total capital, surplus, undivided profits and deposits of banks in U. S.; usefulness of banks; disastrous effects of bank failures; growth and development of banking business; ignorance concerning banks; attacks on banks and bankers; education necessary in banking principles and functions.	
CHAPTER TWO. BANK DIRECTORS	13
Why directors are necessary; oath required of directors; who may be directors; stockholders' meetings; minutes of stockholders' meetings; first meeting of directors; directors being aroused to their duties; county bankers' associations; powers of board of directors; banking business confidential; the ideal board.	
CHAPTER THREE. OFFICERS AND EMPLOYEES	23
Banking business depends on confidence; cannot be conducted without board of directors; power of board; reciprocal relation of directors and officers; the bank's president; the cashier, junior officers and other employees; American Institute of Banking courses; danger of a one-man bank; bank cashiers underpaid.	
CHAPTER FOUR. DEFALCATIONS AND BANK FAILURES	38
Causes of bank failures; narration of actual cases; directors' duties and liabilities; inactivity of directors or failure of directors to administer the affairs of banks; public deposits; excessive loan limit and no restriction to borrowing; the bank crook; the ignorant and untrained banker; the wild cat bank; use of funds of bank by officers and directors; inadequate laws and infrequent examinations; periods of business depression.	

	PAGE
CHAPTER FIVE. DIRECTORS' MEETINGS	63
General outline for conducting a bank; suggested order of business for directors' meetings; minutes of directors' meetings.	
CHAPTER SIX. BANK SUPERVISION AND EXAMINATION	75
Purpose of bank examinations; objects and purposes of banking departments; duties and responsibilities of bank supervisors; bank supervision in North Carolina; the bank examiner, his duties during and after examination of a bank; limiting number of new banks; the personal element in bank supervision; meeting of directors in connection with examinations.	
CHAPTER SEVEN. DIRECTORAL DUTIES, RESPONSIBILITIES AND LIABILITIES	98
Duties—to exercise general supervision; directors cannot shirk duties; must discharge duties with care; contract for reasonable capacity, skill and care.	
Responsibilities—responsible for acts of officers; must know how bank is being run; directors more than mere figureheads; held responsible when position as director is accepted.	
Liable—for lack of supervision; to creditors and stockholders; for failure to charge off worthless assets; to depositors; for gross negligence; for willful failure to attend board meetings.	
CHAPTER EIGHT. THE DIRECTORS' AUDIT	113
Directors required by law to audit their bank; the auditing committee; procedure for committee; verification of assets and liabilities; discussion and suggested forms.	
CHAPTER NINE. THE BANK STATEMENT	156
Loans and discounts; acceptances; overdrafts; United States securities; other bonds, stocks and securities; banking house; furniture and fixtures; other real estate; lawful reserve with Federal Reserve Bank; amount due from other banks; exchanges for clearing house; checks on other banks in same town; checks and drafts on	

CONTENTS

xi

PAGE

banks located outside of city; cash items; redemption fund; other resources; capital, surplus and undivided profits; circulating notes; amount due to national banks; amount due to other banks; certified checks; cashiers' checks; individual deposits subject to check; state, county and other municipal deposits; dividends unpaid; certificates of deposit; postal savings; U. S. deposits; U. S. Government securities borrowed; other bonds and securities borrowed; bills payable; rediscounts; reserves; other liabilities.

INDEX 185

THE DUTIES, RESPONSIBILITIES AND LIABILITIES OF BANK DIRECTORS

CHAPTER ONE

THE BANKING BUSINESS

CLEARLY banks differ from other business enterprises. In no other business are so many individuals directly interested as is usually the case in a bank, where not only the stockholders are interested, but also the customers (depositors) to even a greater extent. Almost uniformly the depositors not only outnumber the stockholders, but have "invested" in the way of deposits, many times the capital of the bank. A recent compilation shows the total capital, surplus and profits, the stockholders' investment in all banks in the United States to be \$6,726,443,398.41, while the total deposits amounted to \$46,001,452,641.94. The number of stockholders and depositors is not available, but the ratio is much greater than that of invested capital to total deposits.

It would be difficult to define more concisely and portray a more vivid picture of the usefulness of banks and the far-reaching disastrous effects of bank failures than is set out by the Kansas Supreme Court in the case of *Schaake v. Dolley*, which follows:

"Banks are indispensable agencies through which the industry, trade and commerce of all civilized countries and communities are now carried on. The banker is the uni-

versal broker over whose counter the exchanges of supply and demand are, in the final analysis, effected. The capital which he has invested and the returns which he receives upon it are insignificant in importance to the advantages which society at large derives from the conduct of the banking business, and the evil consequences of unsound banking are distributed between the banker and the general public in like proportion. Banking is not a business 'affected with a public interest' in the sense in which Lord Hale first used that expression in the treatise '*De Portibus Maris*.' But banking has ceased to be, if it ever was, a matter of private concern only, like the business of the merchant, and for all purposes of legislative regulation and control it may be said to be 'affected with a public interest.' The public patronage which the banker invites and receives is of such a character that he becomes in a just sense a trustee for the fiscal affairs of the people of the state. If a merchant cannot meet his bills promptly, the general public is not disturbed. He is not ruined at once and if he fails the effects are limited to comparatively few persons. If a bank is unable to meet a check drawn upon it, the refusal to pay is an act of insolvency. Its doors are closed, its business is arrested, its affairs go into liquidation, and the mischief takes a wide range. Those who have been accommodated with loans must pay, whatever their readiness or ability to do so. Further advances cannot be obtained. Other banks must call in their loans and refuse to extend credit in order to fortify themselves against the uneasiness, and even terror, of their own depositors. Confidence is destroyed. Enterprises are stopped. Business is brought to a standstill. Securities are enforced. Property is sacrificed, and the disaster spreads from locality to locality. All these incidents are of common knowledge and experience. They clearly distinguish banking from the ordinary

private business, illustrate its public nature and show that it is properly subject to the police power of the state, vested in its legislature."

During the last few decades, with the rapid development of the entire nation, the banking business has had a rapid growth and expansion and there have been many changes in the functions and practices of banks. There have been disastrous experiences, but with it all great strides have been made in the banking business. Numerous laws have been passed by the Federal Government and all the states providing for the supervision of banks and the safeguarding of depositors and stockholders. To-day we have one of the strongest banking systems in the world divided into two general classes: National Banks and State Banks, with a total, on March 31, 1924, of 29,465 banks, of which 8,115 were National Banks with total resources of \$22,062,888,-000.00 and 21,350 State Banks with total resources of \$33,641,174,000.00.

The National Banking Act was passed by Congress in 1863, while many of the states had no banking laws governing the operation of banks until recent years.

It is indeed gratifying, when we take into consideration the large amount of business transacted by banks, that they were so uniformly successful in the various states without supervision. It has been in the state system that so many experiments have been tried and the wide powers and varied functions of banks developed. While there have been disasters, as a whole, the success of banking speaks well for the managers of the thousands of banking institutions which operated for many years without supervision.

If banks are indispensable agencies for the carrying on of business, is it not essential that every person dealing with them should know something of banking principles and functions and is it not of paramount importance that

those entrusted with the direction of the policies of banks and the governing of their operations should be particularly versed in the functions of banking; not those details which the banker must know for the daily routine of his business, but those principles which are in accord with good banking and sound economics, in order that the affairs of all banks may be properly managed and that they may function properly and to their fullest extent? As for those actively engaged in the management of banks, there is little, if any, excuse for ignorance of fundamental principles and functions. With the large number of banking journals and the excellent works on these subjects, any one desiring to do so may readily acquaint himself with them and keep himself posted, by giving only a little time to reading.

There has always been, in the minds of the general public, too much mystery regarding banks. It is appalling to learn of the vast numbers in all walks of life who do not understand the functions of banks nor appreciate their limitations and for these reasons do not avail themselves of the advantages or abuse the privileges offered. Whether this is the fault of the public because of insufficient interest to inform themselves or whether it can be laid at the door of the banker, is a matter that will not be discussed in this volume. Whatever the cause, the banker can do much to overcome, or at least improve, this unfortunate condition and dispel the mystery which remains in the minds of far too many. In doing so bankers will broaden their fields, thus enlarging their usefulness and extending the services of banks. If bankers would direct their efforts along well-planned educational advertising lines, explaining in a clear-cut manner the fundamental principles and functions of banking, much could be done to educate the general public in these matters.

Hundreds of thousands will never be reached through the most extensive advertising campaign. A plan has been

adopted by the American Bankers Association which bids fair, if supported by the bankers as it should be, to do much good along this line. This organization is making an earnest effort to incorporate banking and savings into the courses of our public schools. Courses and lectures have been prepared for the bankers to take into the schools. Splendid results have already been accomplished and if the bankers will take hold of this as they should it can be made one of the biggest factors in educating the on-coming generations in the fundamentals of banking. It is true that immediate results may not be seen, but the boys and girls of to-day are the business men and women of to-morrow, and this plan of the American Bankers Association cannot be too highly recommended.

At a meeting of the Executive Council of the American Bankers Association in May, 1922, Mr. Puelicher, Chairman of the Committee on Public Education of the Association, in explaining the work and its purposes said:

"Economic education is one of the world's greatest needs to-day. The problems of America are largely economic. We have no political problems of moment to deal with. Europe has these, and I believe they are being solved. What the whole world, America included, needs, is a better knowledge of fundamental economics.

"The Committee on Public Education of the American Bankers Association undertook to work out a program which would make the bank and its functions more generally understood by the people of America. We started with the thought of teaching the children in the higher grades of the public schools, the seventh and eighth grades, the high school, the colleges and universities, feeling that a better understanding of the banker and his purpose would mean much to the welfare of our nation; feeling that the banker was often very much misunderstood; feeling that

while he was the respected adviser of his own clientele, those outside of the four walls of his office hardly knew him; feeling that the banker had not taken that large part in public life which would be best for the public."

Continually, bankers are being attacked on all sides. First one faction and then another complains that it is not receiving the consideration it should have, that credit is being denied it, that it is being discriminated against. Usually these attacks are unfounded, the result of a lack of knowledge of the fundamentals of banking and economics. An editorial in the July 21, 1923, issue of the *Saturday Evening Post* deals with this so clearly that it is here given in full:

"Of all institutions which make business operations possible none so arouses the ire of persons who would sovietize this country as the bank. There are many counts in their indictment of banks and bankers. Indeed, merely to enumerate all the points in this reckoning is hardly possible, for the very word "banker" is synonymous in the minds and mouths of radicals and agitators with all that is wrong and harmful in existing institutions.

"The fact stands out, however, that the banker takes in on deposit the money of the entire people and does not always, in the opinion of his critics, use either the money or the undoubted power which goes with its possession for the best interest of the people. Yet it has long been true that banking, in this country, at least, has been an open field which practically all might enter. Given only a moderate accumulation of savings and the confidence of at least a portion of the community, any small group of men might enter the business and reform its supposed evils.

"If there is one institution in American life which conforms more closely to our theories of democracy and individual initiative than another it is the bank. Despite the

tendency toward large banks in the main centers of population, the fact remains that there are still something like thirty thousand banks in the country, the vast majority of them owned and administered by simple American home folks who are not connected with Wall Street or the money power that is supposed to reside there.

"Not only is banking open in theory to all who conform to the relatively modest requirements but it is a matter of common knowledge that new banks, large and small, but especially small, are being constantly started by all sorts and conditions of men, from the most powerful Wall Street financiers down, or up, to the farmers, builders, doctors, lawyers, bakers and candlestick makers of the smallest hamlet.

"If any thoroughgoing communist really wishes to understand the banking system and its personnel he should drive through a score or so of country towns and study the occupation and personality of the typical bank director, stockholder, officer and employee, instead of confining his observations solely to the lower end of Manhattan Island. It is true that in indicting the banking system of the country one really indicts the average typical small-town American, and the American people itself.

"Just because a business institution is typically small-town and American, it cannot on that account be given permanent and perpetual immunity from all criticism. Banking, like other business institutions, is subject to improvement. New ideas may be needed. It is not a field above or too sacred for experimentation. There have been many and constant improvements, and there will be even more. But it is a sign of empty-headedness to proclaim in advance as a success what is only at the time an experiment.

"Unfortunately for the constructive improvement of banking theories and practice, much of the criticism is

either unbelievably unintelligent or else wholly dishonest. When great emphasis is laid on the fact that bankers use the peoples' money for what is not the peoples' best interest, the real meaning that is stated or implied is that money is not easy enough to borrow. The idea is that because most of the money in the banks is put there by depositors—that is, by the people at large, rather than by a relatively few stockholders—the people at large should have no trouble in borrowing all they want.

“But the banker's first duty is not to lend money. His first duty is to return deposits on demand or at the end of an agreed-upon term. Important as credit operations are to the whole structure of industrial society, the bank rests originally and primarily upon its ability to return deposits intact. The banker's first duty is the protection, the conservation of his deposits. He is compelled to that by the moral obligation which rests upon him and by the whole framework of the law, including the double liability which usually rests upon his stockholders.

“The individual or even the business enterprise which deposits money in a bank does so with the ideas of safety and convenience in mind. Safekeeping, however, is the primary idea. There cannot be two primary ideas. Borrowing must come second or third. Thus the banker must be cautious when he lends other peoples' money; far more cautious, indeed, than when he lends his own.

“From the very nature of his business the banker must always be in somewhat of a quandary. To make anything at all for his stockholders he must lend the depositors' money, but prison gates yawn for those who lend it unwisely. Only the most colossal ignorance or a wholly destructive turn of mind can explain those who criticize the banker for being reasonably cautious and conservative. How can any honest man who is not a fool be otherwise

than cautious and conservative when he lends another man's money?

"It has been said that the end of our theory of government is in sight when the savings of the people cannot be trusted to the banks. Fortunately, to an overwhelming degree, that trust is one which now exists, and which no agitation has yet been able to break down. But it is a fair question whether bankers, instead of being too careful in their use of the peoples' money, are careful enough.

"It is difficult to imagine a stronger framework of law for the protection of bank depositors than is provided by the national bank act and by many state banking laws. Yet there is a constant slipping through the net of dishonest and incompetent bankers. In the main the banking system of the country is dependable and trustworthy to a degree, but there are enough exceptions to make constant vigilance necessary.

"When the banker is blamed because he pays a smaller interest on deposits than he charges on loans, or because he forces payment or forecloses on the lender, or because he is generally cold-hearted in his attitude, it is apparently forgotten that centuries of legislation have hammered into him the idea of safety, security, responsibility and trusteeship for the depositors' money. It is forgotten usually by the outsiders, but never by the banker, that if he loses the depositors' money the stockholder is subject to a double liability, and investors will not so subject themselves unless they have an assurance of fair profits and considerable security in other ways.

"But none the less there is the bank teller or cashier, and now and then the president, who goes to the bad because of women or of speculation in stocks. There is the banker who is just a plain darn fool, and there is the one who is thoroughly yellow and dishonest all the way

through. These types appear and reappear, although naturally failures increase after the bursting of any sort of boom. The percentage of dishonesty, rottenness of character, and complete incompetence among bankers is low, but there is quite enough to warrant ceaseless vigilance on the part of examining and regulating authorities.

"Naturally banking cannot escape from the weakness of all business effort, whether private or governmental, which is the desire to make a good showing. Customers are what all business organizations, public and private, want. Banks seek deposits and profitable loans, and do not always reckon on the risk.

"The persistency with which banks are denounced for not lending more freely is difficult to understand in view of the repeated losses suffered from lending too freely. It is said that banks constitute a money trust, yet many of them commonly give recommendations to concerns which have never deserved a single good word and would certainly never get it from any money trust worthy the name. Much is said of how banks favor their friends, and especially insiders, so called. But perhaps the most striking fact about banks to those who deal in facts rather than in buncombe is how good they are, far too good, to total or almost total strangers.

"Indeed, the most curious fact about many bankers is how often they are unable to detect bad character, unsafe practices and unsound finances until after the crash. They extend credit to a vast multitude and variety of enterprises and individuals, and out of these myriads a number always prove poor investments.

"If the banks are engaged and joined in a conspiracy to use the peoples' money for the bankers' profit and the oppression of the people they are not very successful at the game. If the banks possess and exert as much oppres-

sive power as the radically inclined assert, it is strange they sustain so many business losses. If their system for beating the people is so perfect it is strange that every now and then a banker goes to jail or commits suicide because he has been discovered in misusing the peoples' money.

"Banking might be made more safe for the depositor, but hardly more acceptable to the parlor pink, if the thirty thousand mostly separate institutions were reduced to half a dozen, somewhat after the British fashion. It might be made still safer and thoroughly acceptable to the pink, for the moment, at least, if the Federal Government took over the banking functions entirely. That would settle the whole question; especially if the railroads were taken over at the same time, and a few of the larger industries, such as the oil, steel, packing house, telephone, telegraph, electric light and power, and automobile industries.

"For then we should cease to be a free and democratic nation with all the worries that go with it. There would be no point in finding fault with the banks, railroads or anything else. With a few bureaucrats controlling the situation there would be no sense in complaining to them or at least no more than in objecting to what a Soviet commissar decrees. Under our present system we have all the pains, difficulties and troubles of free institutions, individual initiative and opportunity for all. It is a very great nuisance, because it places considerable responsibility upon the individual American. Why not shift it all to a few politicians and autocrats?

"Industry and commerce, including banking, would be so simple under such an arrangement. There would be no need of private stockholders in banks, no dividends and no profits. Naturally under government banking it would be hard to refuse loans, to discriminate against borrowers. The borrowers might have enough votes, or bayonets, to

turn the bureaucrats out of power and put in a new set. Thus the losses would be heavy, but that wouldn't matter at all. They would be made up out of taxation.

"In this fashion industry after industry could be taken over, and if any losses were sustained the taxpayer could be pinched again. Of course in time there would be no taxpayers left, no wealth to tax. But what of that? Why not start civilization over again from the Stone Age? It would really be easier than progressing in an orderly fashion from the point already reached. It takes much less headwork to break a piece of machinery than to make one."

At least a part of the blame for the attitude of some classes of people can be placed on the bankers for too often, matters arise which the banker does not discuss frankly with his customers, when, if these matters were explained in a clear and concise way the customer would readily understand the banker's viewpoint, instead of being left in that state of mind which gives itself to criticism because of misunderstanding. The attitude of the banker of "Oh, well, what's the use, he will not understand anyway," should be entirely eliminated, and whenever the banker has the opportunity to enlighten his customers along fundamental banking principles he should not fail to grasp that opportunity.

The laws of the various states governing banks differ so materially that it would not be practical to attempt more than a general discussion of the functions of a bank in this volume. The laws of the state in which you have banking interests should be studied, that a knowledge of their provisions and requirements may be had. Copies of the banking laws of the various states and the Federal Government may be procured from the banking departments of the respective states or the comptroller of the currency.

CHAPTER TWO

BANK DIRECTORS

IN most instances corporations, including banking corporations, have numerous stockholders. The laws of the various states and the Federal Government differ in respect to the minimum number of stockholders required for banks. If all corporations were closely owned, and had only a few stockholders, it would be comparatively easy for these few owners to manage the corporation's business. However, since it is a fact that corporations, and banking corporations are certainly no exception, generally have a large number of stockholders, widely scattered, and many of them never visiting the domicile of the corporation, it is easily seen that it would be almost impossible from a practical standpoint, and to say the least too cumbersome, to depend on all the stockholders to participate in the management of the corporation, especially in acting on matters pertaining to immediate business needs. With a large number of stockholders we well know that it would be most improbable that they would agree on important business matters and policies. Especially is this true with banking corporations where we find the stock so widely distributed "for the influence" such distribution may have, and where the stockholders are of almost every trade and profession, a large percentage of them knowing little about banking principles and functions.

Our law-makers, realizing the importance of a means for prompt action in the operation of corporations, have

provided that stockholders may select a few of their number to direct the policies and manage the business of their companies. So important is this that absolute management is placed in the hands of these few, the other stockholders reserving for themselves, generally speaking, only the right to choose these managers and to amend their articles of incorporation. The managers chosen by the stockholders are called directors, and to them is due, to a large extent, the success or failure of the enterprise.

In all corporations the directors have grave responsibilities, but in none are they so heavy as in banks, where they have not only the stockholders' interest, but also thousands of depositors to whom they are responsible for the funds deposited in their institution.

So important are bank directors and so grave their responsibilities that they are repeatedly referred to as "trustees" (trust officers) for both the stockholders and depositors. The courts have clearly indicated this, as well as the personal liability of directors for neglect of duty or willful violation of the trust imposed in them. And why should this not be? Have not the stockholders vested in the directors all their interests in the corporation to manage and protect, and divested themselves of their right to govern their own property? And have not the depositors entrusted to the bank, therefore to the directors, their savings, believing that these directors are charged with the duty of safeguarding them?

Directors of National Banks, as well as of state banks in practically every state, are required to take an "Oath of Office." The oath required of national bank directors is as follows:

"I, the undersigned, director of the.....
National Bank, located at, being a citizen of
the United States, and a resident of the state of,
do solemnly swear (affirm) that I will, so far as the duty

devolves on me, diligently and honestly administer the affairs of said association; that I will not knowingly violate, or willingly permit to be violated, any of the provisions of the statutes of the United States under which this association has been organized; and that I am the owner in good faith and in my own right, of the number of shares of stock required by said statutes, subscribed by me or standing in my name on the books of the said association; and that the same is not hypothecated nor in any way pledged as security for any loan or debt."

This oath sets forth some of the legal requirements of a director, viz: he must own in his own name the requisite amount of stock unhypothecated and not pledged in any way, he must be a citizen of the United States, he must diligently and honestly administer the affairs of the bank, and he must not knowingly nor willingly permit the banking laws to be violated.

To become a bank director one does not need to know all the laws affecting banks, nor does he have to be particularly versed in the principles of banking, yet he should acquire a knowledge of the banking laws of his state and acquaint himself, as much as possible, with good banking practices. It is hard to believe any bank director would neglect to acquaint himself with the banking laws and practices of his state if he were apprized of his full duties, responsibilities and liabilities, and there is little, if any, excuse for ignorance of fundamental principles and functions.

Judge Earle (*Hun v. Cary*, 82 N. Y., 65) said: "Like a mandatary, to whom he (a director) has been likened, he is bound not only to exercise proper care and diligence, but ordinary skill and judgment. As he is bound to exercise skill and judgment, he cannot set up that he did not possess them.

"When damage is accused by his want of judgment, he

cannot excuse himself by alleging his gross ignorance. One who voluntarily takes the position of director, and invites confidence in that relation, undertakes, like a mandatary, with those whom he represents or for whom he acts, that he possess at least ordinary knowledge and skill, and that he will bring them to bear in the discharge of his duties."

Bank directors are chosen from every vocation. On one board will be found a dentist, a poultryman, a druggist; on another board a minister, a contractor, a railroadman; on another a doctor, a merchant, a farmer. When one becomes familiar with the vast and varied directorates the combinations are often amusing, and yet the faithfulness of these directors and the success of the thousands of banks they manage is truly gratifying.

The stockholders should use precaution in the selection of their directors, and see that only those are chosen who are capable of managing the bank, and who will give enough of their time to fulfill the duties imposed on them as directors. A letter addressed to a state banking department will illustrate the importance of this:

"Our board of directors is still inactive and may as well continue to be, for all the good it will be to have them meet. The board is composed of one man and four inexperienced married women, one of whom lives out of town and cannot attend the meetings. Another lives out on a farm near by, is old, is the wife of a farmer, and has no idea on the conduct of a bank, cannot even comprehend what is going on at the meeting. The other two members, who are also married women, reside in other cities."

Often the annual stockholders' meetings are mere formalities, the only business receiving attention being the election of directors. Too often these elections are controlled by one or two men, the other stockholders voting in accordance with the suggestions of the dominating stockholders.

Many times we find prominent citizens being elected directors in order that their name may lend solidity to the bank and attract deposits, while in some cases these men know nothing about banking business, in fact are sometimes chosen for that very reason. In other cases they are so engrossed in their own business and personal affairs that they do not give the bank the attention they should, if any at all.

*“There is considerable lack of knowledge on the part of stockholders as to their right to vote at the annual stockholders’ meeting for the election of directors. In this respect the laws of the various states differ but the general rule is: At all stockholders’ meetings each share of stock entitles the owner to one vote and a stockholder may vote at any meeting of the stockholders by proxy. In all elections of directors of an incorporated bank each shareholder has the right to cast as many votes in the aggregate as shall equal the number of shares held by him in said bank, multiplied by the number of directors to be elected.”

It is essential that full and complete minutes of all stockholders’ meetings be kept in a book provided for that purpose. A record of each share of stock represented at the meeting whether represented in person or by proxy, should be embodied in the minutes, and all proxies should be filed and carefully kept.

†“Minutes of the stockholders’ meetings should be prepared and recorded in substantially the following form:

MINUTES OF STOCKHOLDERS’ MEETINGS

(Suggested Form)

Minutes of the annual stockholders’ meeting of the Prosper State Bank of Prosper, Oregon, held pursuant to

*“Bank Directors—Their Powers, Duties and Liabilities,” Banking Department of Kansas.

†“Rules and Regulations, Banking Department of Oregon.”

law at the banking rooms in the city of Prosper, on Thursday, January 15, 1921, with President John W. Prosper, presiding.

On roll call being made the following number of shares were represented:

	<i>In Person</i>	<i>By Proxy</i>	<i>Total Shares</i>
J. R. Williams.....	25	10	35
John W. Prosper.....	85	36	121
Chas. A. Brown.....	10	10	20
J. L. Stewart.....	28	31	59
R. W. Howe.....	36	12	48
A. L. Jones.....	41	26	67
J. A. Smith.....	23	31	54
	<hr/> 248	<hr/> 156	<hr/> 404

More than a majority of the 500 shares issued and outstanding being represented, either in person or by proxy, and all proxies presented appearing to have been legally executed and filed, the president then announced that the first business to be transacted would be the election of five directors for the ensuing year, and declared nominations to be in order. Whereupon, the following stockholders owning more than five shares each, unincumbered, were nominated in the order named, for the office of director:

J. R. Williams by John W. Prosper.

J. W. Prosper by Charles A. Brown.

Charles A. Brown by A. L. Jones.

R. W. Howe by J. L. Stewart.

J. L. Stewart by J. A. Smith.

There appearing to be no further nominations it was moved and seconded that the nominations be closed, and that the secretary be instructed to cast a unanimous ballot in favor of respective nominees above named.

A ballot was cast pursuant to said motion, and the stockholders nominated were duly elected to the office of directors by unanimous vote.

There appearing to be no further business the meeting adjourned.

JOHN W. PROSPER, *President.*

Attest: CHARLES A. BROWN, *Secretary.*

"Immediately after the stockholders adjourn the directors should call their first meeting and properly organize by the election of officers. Salaries of officers should be fixed for the ensuing year. The board should then appoint a loan and discount committee, or finance committee, also a committee of stockholders to make examinations and inquire into the condition of the bank when required by this department.

"At this meeting of the new board of directors all reports, oaths of office, official signatures, etc., as required by this department should be completed and signed, for prompt transmittal to the superintendent of banks. All plans for the current year should be discussed. All policies and the manner which the institution is to be managed should be fully outlined and, if necessary, by resolution made a part of the minutes."

There still remain some instances where banks are operated for almost the exclusive benefit of their directors. Not many years ago it seemed to be the general idea that the directors of banks could use all the money they wanted, and the position of bank director was a much coveted one, in many instances, for that reason.

Few instances now exist where banks are run for the benefit of their directors, and these are rapidly passing. Many banks do not make loans to their active officers or directors. While this may be the ideal condition, there surely can be no valid reason why these should not be entitled to lines of credit on the same basis that other lines are granted, but certainly they are not entitled to

indulgence. Too often a director will need money which he will borrow from his bank. A little later another director will need a loan, and there will be the feeling that "I approved a loan to you, now you should reciprocate." Again, active officers are often backward about holding down the directors, or a particular director, for to the board this officer looks for his job.

More and more bank directors are realizing their responsibilities. Particularly is this true wherever their attention has been called, by the proper authorities, to their duties.

A short time back the Bank Commissioners of several states undertook to inform bank directors of their responsibilities. The Bank Commissioners of Arkansas made a tour of that state and held "Schools of Instructions" for bank directors, outlining to them their duties as bank directors, and how to fulfill them. These meetings were held by the Bank Commissioner on the same day and in the same town as the group meetings of the Arkansas Bankers Association.

It sometimes seems that the bankers' conventions, both state and group, are attended to exclusively by the active officers of banks. True, these men should attend, but if bank directors would attend more of these meetings our banks would be better managed and the respective communities would profit thereby. Nothing could be more beneficial to a director or his bank than attendance at these meetings. Especially is this true of the Group Meetings, for at these the problems of the particular locality are discussed—those problems which affect the local bank and are therefore, or at least should be, of vast importance to the directors.

In some states County Associations have been organized. Officers and directors of all banks in the county get together once or oftener each month and discuss local and

general conditions and problems. These county organizations can be made of great benefit with almost unlimited possibilities for good. They deserve the serious consideration of all bankers. In Arkansas 49 of the 75 counties of the state are so organized and much good is being accomplished.

*"The law intends that the power to manage the business of a bank is vested in the directors AS A BOARD, and no individual director has authority to act for the bank, except in cases where the board of directors delegate the power to him as an agent of the bank. The board must be duly convened and act as a unit before it can represent the corporation. The assent of the members of the board acting separately and individually, is not the act of the corporation. The law was enacted upon the theory that the directors should meet and counsel with each other, and that any determination affecting the association should be arrived at and expressed only after a council of the board, at a meeting attended by at least a majority of its members."

The nature of the banking business requires that most of the bank's transactions be kept in strictest confidence. For this reason, if for no other, every director should at all times use the utmost care in his remarks concerning his bank. Unfortunately, there are directors who talk too much, not realizing that they are betraying the confidence placed in their banks.

Many directors are not faithful to their stewardships. A breach of trust on the part of a director makes him liable to those suffering thereby. For making false representations to depositors; for lending more money to any one borrower than is permitted by law; for gross negligence or

*"Bank Directors—Their Powers, Duties and Liabilities," Banking Department of Kansas.

failure to perform duties imposed by law, directors are personally liable for damages.

The ideal board would be one composed of men expert in their own private businesses; men who have encountered life's business and social problems, and through actual experience are fitted to act as fiscal and advisory agents for the public; men who have the inclination, and will take the time, to attend the meetings of the board and supervise the bank's general policies; competent men who in every way are fitted to uphold the hands of their officers.

A director who cannot give the time required to become familiar with the affairs of his institution should resign.

CHAPTER THREE

OFFICERS AND EMPLOYEES

BANKING business is built and maintained on confidence. Let the confidence of a bank's customers be shaken and the institution is doomed to ruin, for deposits are immediately withdrawn, even to the point of causing the closing of the bank, and confidence lost is difficult to regain.

It is often said that the personnel of a bank is its greatest asset, success or failure depending largely upon the character of its directors and officers. Safe, sound and legitimate banking is seldom conducted with men of bad habits or questionable character as officers of a banking institution. Clearly, then, it is of paramount importance that only men of the highest honesty and integrity be chosen as the managers of banks.

At the head of a successful bank will be found a man who is always at his post; one who as faithfully guards the treasure of those who confide in him as he does his own; a man of sober judgment, unquestioned integrity and recognized business ability; but experience has proven and it is now generally accepted that:

*"The life of a corporation and its business cannot exist or be conducted without a board of directors. They are delegated with certain powers and duties by law which cannot be transferred or conferred upon agents. A director cannot delegate a responsibility which the statute imposed upon him to specially and personally perform. But for

*Magee, "Banks and Banking," p. 96.

the purpose of carrying into execution the usefulness and management of its details in business many of the powers conferred upon the corporate bank may be delegated to agents created by the board of directors, and while this is true, and although they may not be required to perform all the transactions which daily occur, they are bound to know all that is done beyond the merest matter of daily routine."

*"A question of much importance is, To what extent may the directors commit the management and control of its executive officers? In practice, the powers of such officers vary greatly. In some instances they are allowed to have almost full control of the bank's business, while in other cases they perform no more than routine duties without consulting with the board or one of its committees.

"There are many things which, in their management, require the utmost diligence and most scrupulous attention, and where the agent who undertakes their direction renders himself responsible for the slightest neglect. There are cases where the duties imposed are presumed to call for nothing more than ordinary care and attention, and where he exercises that degree of care it suffices. Officers on whom compensation is bestowed for the employment of their time in the affairs of the bank, have the immediate management. In relation to these officers the duties of directors are those of control, and the neglect which would render them responsible for not exercising that control properly must depend on the circumstances, and in a great measure be tested by the facts of the case.

"The directors convened as a board and are the primary possessors of all the powers of the bank, and like private

*"Bank Directors, Their Powers, Duties and Liabilities," Banking Department of Kansas.

individuals they, as a board, may delegate to agents of their appointment the performance of any act they themselves can perform. They, as a board, may delegate to the president or cashier authority to handle certain matters connected with the business of the bank. They may appoint a discount committee or any other committees important to the proper conduct of the bank, but they must not get away from the idea that this does not relieve them, individually or as a board, from the proper conduct of the bank. The fact that the power to handle the details of a bank is given to a cashier in no way relieves a director, or the board of directors, of their responsibility for the safe conduct of the bank, and this fact should be remembered by them. The board of directors has power to authorize the president or cashier to borrow money or discount paper owned by the bank, and neither of these things should be done without authority from the board."

It is true that most bank directors are men of affairs and therefore have their own business to look after. Usually it is such men that are the most desirable bank directors, for they are able to understand the many problems presented in the course of the bank's business.

A director cannot be expected to neglect his business for that of the bank, for often his monetary interest in it is small compared with his other investments, but as is set out in so many places in this volume, when a man assumes the directorship of a bank he assumes a most serious trusteeship, and unless he discharges that trust he violates his oath and makes himself liable.

The directorate of a bank is an advisory board and the active manager, whether he be president, vice-president or cashier, is entitled to the support and advice of a directorate that meets regularly and works earnestly.

The active officers of banks often complain that they cannot get their directors to take an interest in the bank's affairs. It is true they "usually" attend the board meetings, but even then they are always in a hurry to "have it over." They do not at other times discuss with the active officers the bank's affairs, and very seldom is a director found who actually takes enough interest in his institution to "boost" it. Most directors are eager to have their banks progress, and especially to have them make money, but all too few realize that, in reality, they are doing little to assist the active officers accomplish those things which are required of them, and which the directors expect of them.

Very often the officers complain of these things, when in reality it is their fault that the directors do not take a more active interest. If the officers would furnish directors with information relative to the bank and its growth—using comparative statements for this purpose—and show them wherein they can be of service in building up the institution, many directors would become sufficiently interested to assist.

The officers of a bank should freely go to its directors and discuss the bank's problems with them, and just as freely the directors should go to their active officers, to see if they can be of assistance by giving counsel and advice.

There will often be differences of opinions about various matters, but usually, if the officers and directors are reasonable men, as they should be, the matters can be "talked out," and a sound and agreeable conclusion reached.

Many banks, especially the smaller ones, make the mistake of requiring too much of their active officers. Often the cashier or all of the officers are required to occupy their time at tasks which are beneath their qualifications. Often a \$200.00 man is required to do the work of a \$50.00 clerk.

The active executive officer of a bank should be given a chance to get out of his bank, and meet his customers at their homes and business. A cashier who is able to visit his farmer customers at their farms, go over their problems with them and inspect their farms and equipment, is in much better position to pass on applications for loans when they are made. The customers appreciate these visits much more than is often realized.

Bank officers should be allowed to attend bankers' meetings, especially group and state meetings, and the bank should pay for this. It does a man good to get out and meet other men, exchange ideas with them, and get their views.

Many banks are seeing the importance of requiring their employees to take a vacation each year, giving them full pay during the vacation.

In most of the smaller banks the president is a prominent business man, one in whom the community has confidence and whose business ability and integrity is unquestioned. He is not often an active officer, the actual management usually falling on the cashier, who is counsellor and advisor of many of the bank's customers, and who should therefore be a man of sterling qualities.

The position of president of a bank does not give him greater power or authority than other directors, but as president of the board it is his duty to call all board meetings. The president derives his powers from the law governing corporations, the bank's charter, the bank's by-laws, and the authority vested in him by the board of directors.

The cashier of a bank is elected by the board of directors for a term, usually fixed at the time of election. In the larger institutions his business is executive and supervisory, but in the smaller institutions his duties embrace

these as well as all others necessary for the running of the bank.

A national bank—U. S., R. S. 5136—cannot hire one of its officers for a specified time. Officers can hold their positions only at the pleasure of the board of directors. The laws of some of the states are specific in regard to this, while the laws of other states make no specific mention of the matter.

As to the junior officers and other employees of the bank—the directors should have great interest in them. If they are carefully selected before employment and properly trained after they are employed, they are logically the men from whom the directors may select their future executive officers. The directors should see to it that the junior officers and other employees have proper instruction to fit them for better positions. There is no better way of doing this than through the American Institute of Banking, which has active chapters in all of the larger cities and which gives correspondence courses for the benefit of those who are not located in the cities where there are active chapters.

Many banks have agreed with their employees that the bank will reimburse them for the money expended in taking the American Institute of Banking Courses, upon completion of the courses and receipt of a certificate. No bank can make an investment which will net it larger returns than this.

Directors should not pry into the private affairs of officers and employees, but their duties in this respect are well set out in the following:

*“It is a part of their (the directors) duty to become familiar with the habits of the employees of the bank; and if they discover that they are speculating, living beyond their means, or have such habits as, if known to the gen-

*“Magee, Banks and Banking,” p. 101.

eral public, would bring discredit and possibly ruin upon the bank with the public, it is their duty to dispense with their services at once. It is frequently said as an excuse for retaining an officer whose habits if publicly known would bring disgrace upon the bank, that 'his ability was unequaled, and the bank could not afford to dispense with him. No one in the community could be found to take his place.' Such excuses should never prevent a director from doing his duty at once by offering a resolution to vacate the position and fill it by a person whose character for honesty, truth and morality has at least never been questioned. Such are some of the unwritten duties, or implied laws, imposed upon directors of the banking corporation."

A bank officer should not be a speculator nor become directly or indirectly a partner in speculation. His outside interests should be limited, for if he is engaged in outside interests there is serious danger that he will neglect the interests of the bank.

Whenever a bank official realizes to the limit that he is acting for other people under a sworn trust, his standard is raised so high that there is little likelihood of a violation of that trust. The bank officer who establishes for himself the reputation of being careful and honest in all his dealings has an influence which reaches every employee in the bank.

Experience has shown that the best managed banks are those which have active directors. The strength of a good managing head should not be lost sight of, either on the board or among the officers, but the concentration of power in a single head is more complete when that head is supported by a board of capable advisors. The board should never forget that at all times the conduct and deportment of the managing head should be watched.

DANGERS OF A ONE-MAN BANK

An address delivered before the Sixteenth Annual Convention of the National Association of Supervisors of State Banks, held at Burlington, Vermont, June 18-20, 1917, by J. D. Covey, Assistant Bank Commissioner of Arkansas.

A one-man bank is confined principally, if not wholly, to small banks, but I have reason to believe that some larger banks are often dominated by one man and it invariably proves a detriment to the institution when such is the case.

I presume I am to point out to you just why a one-man bank is dangerous and to whom it is dangerous.

Permit me here to state to you that in Arkansas we are endeavoring to prevent one-man management, and in doing so the first step we take to prevent the one-man supervision or management, or the one-man bank, is at the close of each examination to call in the directors and have a heart-to-heart talk with these directors. I am going to say to you gentlemen that the day of the big stick has passed and the day of coöperation is at hand. The American people cannot be driven. Our first little lesson that we endeavor to impart to them is that we are not seeking to catch them in error or to catch them in wrongful doings in their bank, but we are delighted to find that everything is in order. We explain to them in our humble way the function of a bank, to begin with. From the standpoint of the stockholder, the primary function of a bank is to make money for the stockholder, but viewed from the standpoint of those who patronize the banks, the primary function of a bank is not profit to the stockholder, but it is in the assembling of the little sums of money that may have before been carried in the pockets of the people and created or put into a reservoir from which may be drawn the sums necessary to carry on the business of the community. The

point we make or emphasize the strongest is the liability of directors in our State, and if you will permit me, in just a minute, I will give it to you.

Our law provides for the double liability upon the stock; if a stockholder owns a thousand dollars in the bank, he stands to lose that thousand if the bank becomes insolvent, and has to put in an additional thousand to care for the creditors of the institution.

The second liability—if they have any public funds on deposit in the bank, they become personally liable, each stockholder becomes personally liable for the public funds. That we may term as liability number two.

Then our courts have held that if directors, by neglect or otherwise, permit mismanagement, they then become liable personally for all the debts of the institution. And when we have shown to these directors their several liabilities, they become interested.

It is said, and truthfully so, that there is wisdom in counsel, and the greatest possible degree of wisdom should undoubtedly be exercised in the conduct and management of any institution having in charge the safeguarding of money belonging to others.

A one-man bank is not necessarily a bank owned by one man, nor is it a bank without a board of directors. The one-man bank I have in mind is one managed, controlled and many times operated by one man. It may have a regularly elected board of directors, who have taken the oath provided by law, a regularly elected President, Vice-President, Cashier and Assistant Cashier, together with a regularly appointed discount committee and auditing committee, bookkeepers, stenographers, and so forth, and yet be a one-man bank—controlled absolutely by one man.

This kind of a one-man bank is to my mind the most dangerous. Its management and control is presumed to be,

and is really, vested in the board of directors, but by indifference and neglect they fail to exercise any supervision and thus the one-man management is the result.

Should the manager, who is always the cashier in a small bank, possess the requisite ability; is capable, trustworthy, has unquestioned integrity, thoroughly honest and a good judge of credits, he will likely make a success of his bank, but a successful bank under these conditions is the exception and not the rule.

It is too frequently the case that when a man finds himself possessed of unlimited power, whether the power is assumed or whether it is legally vested in him, that he does not use the proper discretion in the exercise of that power. This is not the only case in handling financial institutions but applies equally and more forcibly in all institutions of government.

A private bank is more often a one-man bank than an incorporated bank; as many of them are owned by one man and are therefore controlled by one man, however, some private banks are owned and controlled by two or more individuals under a copartnership agreement.

Therefore, it does not necessarily follow that one-man banks are confined to either private or incorporated banks as a class, nor are they confined exclusively to small banks. In the framing of our laws it was deemed provident and advisable to get as far away from a one-man management as possible by providing for the election of a board of directors by the stockholders of all corporations, and delegating to such directors full power to manage and control their institutions. It is true that directors have the power to designate, or elect, from among their number, certain officers to preside over them, and to confer upon these officers certain powers that other members of the board do

not possess, but directors do not have the power to confer upon the officers of the board full power to manage the corporation, as directors can not delegate to others the powers and responsibilities conferred upon them by the stockholders.

It is plainly evident that every means and every effort is now being exerted in all the states, so far as I can learn, to inform the directors, especially of the smaller banks, of the importance of their duty and responsibility, thus eliminating the possibility of one-man management.

This movement is no doubt the result of former experience, which has undoubtedly shown the many dangers incident to one-man management. There are instances pointed out wherein the one-man bank has been extremely successful, but upon the other hand the business world is strewn with the wreckage of many failures which are directly traceable to the too common error of permitting one man to assume complete control and management of the institution.

The one-man bank has proven dangerous many times to both the manager and the depositors of the bank.

To the manager, who is most invariably cashier, because it affords him unhampered opportunity to speculate in any manner he pleases upon the bank's funds, without the fear of being detected by associates, and this temptation, in my opinion, has been the means of wrecking many good banks. He does not begin his career by speculating with any intent to injure his bank, but rather through a desire to acquire wealth quickly, after which he fully intends to reimburse the bank for the funds used. His first venture is not a success and the money is lost. He naturally concludes that he must now do something to regain his losses in order that he may restore the funds taken from the banks, and to do so enters upon his second venture, using the bank's funds

as before, but alas, this second investment proves a failure also and the money is lost.

About this time it dawns upon him that it is about time for the examiner to make his regular visit and he proceeds to cover up his shortage by forging a note or notes which he carries among his other bills receivable as an asset, or he charges the inactive account to one of his customers with a sum sufficient to cover the shortage. He thus develops into a first-class forger—a real shrewd criminal, and his conscience no longer stands guard to warn him of his downward course.

Immediately after the examiner has completed his semi-annual examination and has passed the bank without criticism, the "speculator" congratulates himself upon his successful efforts in covering up his shortage and of course being thus successful he brings himself to believe that he is really a shrewd manipulator and that he can carry on indefinitely this campaign of speculation without detection. At this point his conscience may awake sufficiently to give him a last warning, but without effect.

Now he enters upon his third venture and like the first two it is unsuccessful and the bank's money again is lost. But why follow up further, we know the end of such a career, in fact, we knew the end from the beginning. He was assisted, no doubt, and even invited to enter upon such a course by reason of being the one-man manager. No one to hinder or make him afraid. When the crash comes, and his bank is found to be a wreck, then it is that suffering and misery is brought upon his depositors.

Such failures as pictured here does not only bring suffering and distress among the depositors of the bank, which is serious enough, but it also leads to a loss of confidence in banks generally and that loss of confidence is one of the most difficult assets to restore. No banker can tell the

number of people who pass his door from day to day, who have just put their money in hiding. When a man hides his money no one but him and his God know of it.

BANK CASHIERS UNDERPAID

By W. W. Peavyhouse, Deputy State Banking Commissioner, Kentucky. (Published by the *Southern Banker* and used by permission.)

It is unquestionably a fact that cashiers of banks are the most poorly paid of any other business or professional occupation, considering their responsibilities, their social and moral obligations, the dignity of their positions and the quality of work most of them have to do.

In the majority of instances most of the responsibility of managing and operating banks is placed by the directors upon cashiers. The cashier must assume the burden of passing upon and making the loans. He is held responsible for keeping the records of the bank in proper condition. It is he who must take most of the blame if the business of the bank doesn't grow as it should. If the bank suffers losses on account of bad loans or if adequate dividends are not paid out to the stockholders, the cashier in most cases is held to answer.

Notwithstanding all of this it remains a fact that the salary the cashier receives for his services in many instances is miserably small. Short-sighted directors are to blame for this condition in practically all cases where this is true. They cannot see that to pay a reasonably good salary it will secure or retain the services of the most competent man. They do not realize that a cheap man is in the majority of cases much more expensive than a man who can command a much higher salary.

Directors also overlook the possibility of temptation that comes to the underpaid cashier. Where there is any inclina-

tion toward dishonesty on the part of a cashier the temptation comes to him to supplement his salary without the knowledge of the directors. Once started on this kind of a road the result is liable to be disastrous. This does not often happen, but nevertheless the temptation is there.

It is unjust, unethical, unbusiness-like and unmanly for directors to ask or require a cashier to work for a miserly salary in order that large dividends may be paid out to stockholders. This very often happens, nevertheless.

A recent survey of the reports of the state banks of Kentucky shows the following facts with reference to the salaries of bank cashiers, the comparisons being made on data of 450 banks.

73 banks are paying salaries to their cashiers of \$900 to \$1200 per year;

71 banks are paying salaries to their cashiers of \$1300 to \$1500 per year;

130 banks are paying salaries to their cashiers of \$1600 to \$2000 per year;

107 banks are paying salaries to their cashiers of \$2100 to \$2500 per year;

56 banks are paying salaries to their cashiers of \$2600 to \$3600 per year;

12 banks are paying salaries to their cashiers of \$3600 to \$5000 per year;

1 bank is paying a salary to their cashier of over \$5000 per year.

The following observations are also made:

One bank with assets of \$430,000 is paying its cashier \$1620 per year; another bank with assets of \$350,000 is paying its cashier \$3600 per year.

One bank with assets of \$186,000 is paying its cashier \$1400 per year; another bank with assets of \$191,000 is paying its cashier \$2400 per year.

One bank with assets of \$600,000 is paying its cashier \$1980 per year; another bank with assets of \$120,000 is paying its cashier \$1800 per year.

One bank with assets of \$275,000 is paying its cashier \$1200 per year; another bank with assets of \$157,000 is paying its cashier \$1800 per year.

One bank with assets of \$782,000 is paying its cashier \$1650 per year; another bank with assets of \$301,000 is paying its cashier \$4000 per year.

One bank with assets of \$850,000 is paying its cashier \$1800 per year; another bank with assets of \$850,000 is paying its cashier \$5000 per year.

One bank with assets of \$250,000 is paying its cashier \$1200 per year; another bank with assets of \$200,000 is paying its cashier \$3000 per year.

The above instances are only a few of the injustices disclosed relative to bank cashiers' salaries. There are a number of banks in this state which are paying just and adequate salaries. Some banks are so small that they cannot afford to pay larger salaries. However, the large majority of them can afford to pay salaries commensurate with the responsibilities and are not doing it. The purpose of giving this data is to endeavor to stimulate directors of banks to allow better salaries to cashiers and to let those who may be interested in it, know the true conditions as to the salaries bank cashiers are receiving. The general public is under the impression that bank cashiers receive very large salaries. As a general rule it is the reverse. Four cashiers recently charged with embezzlement were receiving salaries as follows: \$900, \$1200, \$1200, and \$1500 per year.

CHAPTER FOUR

DEFALCATIONS AND BANK FAILURES

A LARGE percentage of the bank failures of the entire country are the outgrowth of violations of law, not necessarily criminal violations, although this is the largest individual cause and many violations that are not technically criminal are virtually so because of neglect of duty on the part of one or more individuals directly connected with the management of the institution which has failed.

Statistics would unquestionably show that most of the bank failures of the entire United States are directly traceable to lack of directoral control. Of the other failures, if their causes were traced back to their inception, it would probably be found that a very small percentage are due to causes wholly outside of this one.

The Comptroller of the Currency in his 1920 report gives the following as "Causes of National Bank Failures":

"Two hundred and twenty-eight, or over one-third, of the 594 failures of national banks were attributed to criminal acts. In 51 of the 228 instances defalcations of officers was the cause, in 128 fraudulent management, and in 49 the banks were wrecked by cashiers or subordinate officers. Unlawful loans—that is, loans in excess of the statutory limit—were the principal causes of 114 of the failures. In 62 of the 114 instances excessive loans were made to officers and directors and in 52 to other than officers and directors. Depreciation in the value of assets was the ascribed cause of 83 failures. Injudicious or careless bank-

ing was the cause of 139, or nearly one-fourth of the total number, and the remaining 30 failures were ascribed to insolvency of large debtors, "runs," non-liquidity of assets, etc.

"In the following table are shown the number and percentages of failures from principal causes since the inauguration of the national banking system.

"Principal causes of failures of national banks in the past 57 years.

	<i>No.</i>	<i>Percent</i>
Causes—		
Involving criminal actions.....	228	38.4
Defalcations of officers..... 51		
Fraudulent management 128		
Wrecked by cashier..... 46		
Wrecked by defaulting book-keeper 1		
Wrecked by assistant cashier... 2		
Involving unlawful acts.....	114	19.2
Excessive loans to officers..... 62		
Excessive loans to others..... 52		
Depreciation of assets.....	83	14.0
Securities 19		
Real Estate 14		
General stringency money market 50		
Failure of large debtors.....	12	2.0
Injudicious banking 139		23.4
Closed by run or in anticipation... 9		1.5
No record of cause..... 9		1.5
	<hr/> 594	<hr/> 100.0

The causes of defalcations are numerous, and while the most frequent is probably speculation, with autos and women second, other causes are insufficient salaries, efforts to protect relatives or friends, and too much outside business. Seldom does a defaulter start out with intent to default. Usually he takes only a small sum at first, fully expecting to replace it within a short time. But plans are frustrated and he is unable to return the money as he

expected. Further demands arise; he is already in the mire so why not go a little deeper, hoping something will happen whereby he may be able to replace the whole amount. And so it grows from a small beginning to sums often of tremendous magnitude. A large defalcation began with only \$500.00, but when the defaulter was finally apprehended nine years later, it was well over three-quarters of a million dollars.

Very seldom does an officer or clerk take a bank position with the avowed intention of stealing. Carelessness is a large factor in defalcations. Carelessness in selection of systems, in attention to employees and in throwing safeguards around them, carelessness on the part of the employee himself. Carelessness is an indication of moral weakness, and that in itself leads to speculation and theft. Supervisors of banks sometimes criticize the active officers and employees most severely because of the condition of the bank's clerical work. This may seem a trivial matter, and while it does not necessarily affect the bank's solvency, it often leads to trouble and is an indication of weakness which should be corrected.

During the examination of a bank it was found by the examiner that the notes were short quite a sum. On previous examinations the clerical work of this bank had been in bad condition and the cashier had been under suspicion. The examiner made inquiry concerning the apparent shortage in notes and was informed that they were held as collateral by another bank. The examiner visited the bank which was supposed to hold these notes and, on making inquiry, found that it did not and had not held them. He immediately returned to the bank under examination, and after going into the whole matter was still unable to locate the shortage in the notes. Diligent search

was made, but without results. The directors were informed, and the cashier was asked to resign. An audit was ordered. Sometime between the visit of the examiner and the auditor's arrival, the cashier "found" all but about \$1,000 of the shortage. Several notes which had previously been pledged as collateral had been returned to the bank and upon their receipt the cashier had thrown them into a drawer with other papers, not even opening the envelope to see what it contained. The other \$1,000 was never located.

An assistant cashier, who came from an excellent family, was always on the job. He never left his work long enough for a vacation. But one time he was summoned as a juror, and had to be out of town nearly two weeks. During that time a check was presented and paid against an account which was inactive. That evening the bookkeeper reported he could find no such account. A day or two later an account was reported overdrawn. The customer was called. He insisted that something was wrong, and that he had several hundred dollars in the bank. On balancing the account it was found some one had been using it.

An auditor was called and arrived on the same day the assistant cashier returned. The assistant cashier did not stay. He went to the safe, took out \$500.00 in currency and left town in "one" of his automobiles for parts unknown. However, he did not get far, and about midnight he was found in the woods feigning insanity. He was returned to his home, and after a few days was able to talk with the auditor. He confessed. His total shortage was over \$6,000. This boy was receiving only \$125 a month, and had practically no other income. Although he was not a sport he had more than one auto, and was living beyond his income, which could have been easily

seen if any of the bank officers had been giving attention to such matters.

Not long ago the accounts of a bank clerk were out of balance. The boy was worried and after a diligent search, which proved futile, he went to the cashier with the matter. The cashier berated him, instead of setting about to assist in finding the error. The clerk was much chagrined. Some time later another error occurred. This time he covered it up rather than get another "bawling out." He "got by" with it. Soon afterward he needed a little extra money. It had been so easy to cover up the error that he decided to take the money needed, and cover it up. He took it—then more—the amount grew—he was caught—lost his position—disgraced—almost wrecked a bank—all because of the unwise action of that cashier.

A large defalcation occurred in which the cashier and assistant cashier were implicated. Each of the defaulting officials was under a \$10,000 bond. When claims were filed the bonding company denied liability, claiming non-compliance with the terms of the bonds, which provided that the bank should be audited at least once each year by a certified accountant. The defaulting officers had seen to it that this provision had not been complied with. Their irregularities had been running for several years, and they knew a thorough audit would reveal their crookedness. Suit was brought against the bonding company. The bank lost. The case was appealed to the Supreme Court, which sustained the lower court, and the bank never recovered a cent. Would it not have been worth while for the directors of that bank to have known the terms of their bonds?

The cashier of a small country bank resigned, and accepted a position with a larger bank in a neighboring town. His accounts had been very well kept, but the president of the bank had become suspicious of him because of the way

in which he had acted in leaving. An audit of the bank's accounts was made covering the period for which he had been cashier, and it was found that he was short over \$2,000. This cashier had practiced petty thievery. When a party would make or renew a note and pay the interest, the cashier would deduct part of the interest, put it in his pocket, and credit the balance. The same practice was employed with exchange collected. He would charge a certain amount and credit exchange with a less amount, pocketing the difference. There were over two hundred individual discrepancies in the cashier's accounts.

"A" had been cashier of a bank for over sixteen years. He was highly respected in the community, and had the confidence of his board of directors. Most of the directors of this bank were also directors of a National bank in the same town. The entire management of the bank was in the cashier's hands, as it was small and required the service of only one man. The directors were busy men and the banking department had sent out an order for an audit to be made by a committee of directors. They received permission to have an audit by a certified accountant in lieu of one by the committee of directors. The audit progressed and was near completion when, one afternoon, the cashier asked the auditor how much longer he would be completing the audit. He was told that it might be a week.

That night the cashier went to the bank, took \$5,125 in currency and some Liberty bonds, locked the safe and vault, and left town. The auditors uncovered a shortage of over \$19,000 which had been running over a period of years. About two weeks later the cashier returned with most of the money taken and gave himself up. He had not been a "high liver" and did not speculate, but had simply been living beyond his income for a number of years.

It is known that the most serious failures are those

caused by the officers who preside over and have the active management of a bank's affairs. Such failures occur as a rule where a majority of the directors are mere dummies.

During nearly seven years' service with a State Banking Department the author has attended and presided over the funeral of more than twenty institutions, and is intimately acquainted with the causes of many other failures. With but one exception, the directors of these defunct banks had been inactive to the degree that they did not direct the policies of the banks, and in that one case the cause arose from a circumstance almost wholly out of the directors' control. That one bank was liquidated in less than a year, the creditors received 100% and the depositors 6% interest in addition. The stockholders received over 80% on their original investment.

The duties of Directors relative to the control, supervision and conduct of their bank, and a Director's liability for lack of attention, is clearly set out in a Missouri case, a summary of which follows:

SUMMARY OF COURT'S DECISION

Lyon v. Corder et al

253 Mo., 539

1. Evidence: Records of Correspondent Banks. In a suit against the directors of a bank to recover losses occasioned by the speculation of its cashier.
2. Bank directors' duties: Duties and Power.
The control, supervision and conduct of the business of a bank is lodged in its board of directors as a collective body. They are not officers and have no power individually to control its management; to do that, they must act as a board, in which capacity they have plenary power to act for the bank, subject to the limitations of its charter and the rights of its stockholders.

They are trustees of the bank's affairs, but for the benefit of the bank and its stockholders, are vested with full power of selection and appointment of the officers and agents to conduct its affairs, and are required to exercise ordinary care and reasonable diligence to prevent loss to the bank from the misconduct of its cashier.

3. Degree of Diligence. The degree of diligence imposed by law upon the directors of a bank to discover thefts and peculations of its cashier and other officers is discussed in two opinions in this case, but a majority of the court do not agree to either; but a majority do agree that, under the facts in judgments, the directors were liable, in a suit by the receiver of the bank, for the moneys appropriated by its cashier, and that the action of the trial court in granting a new trial to the defendants on the ground "that the verdict is against the weight of the evidence," was wrong and the judgment should be reinstated.
4. Liability for Cashier's Defalcations: No Bond—No examination of Reconcilement Sheets: During the time defendants were directors of the bank its cashier was engaged in gambling deals with keepers of bucket-shops; to get money for this purpose he appropriated the funds of the bank by overdrafts of his personal account, and by making fraudulent drafts upon its correspondents or depositary banks in other cities—the directors did not at their monthly meetings examine the state of the cashier's personal account, and did not cause to be submitted to them, or to a committee appointed by them, the monthly return statements called "reconcilement sheets," made to the bank by its correspondent banks, which showed the amounts they had paid out during each month upon the drafts drawn upon them by the cashier, and had they done so such examination and comparison would have revealed the cashier's embezzlement:
 "Held that the directors were liable for the losses to the bank caused by the cashier's peculations, and a verdict against them in favor of the bank's receiver should not have been set aside on the ground that "the verdict is

against the weight of the evidence" but the judgment should be reinstated.

"This presents the question as to the nature and extent of the duty imposed upon the defendants while acting as directors of the Middleton Bank, and whether they exercised ordinary care or reasonable diligence in the discharge of that duty to prevent the loss to the bank from the misconduct of its cashier. The directors of a bank of deposit and discount (as the one in question) are not only trustees of its assets for the benefit of the bank and its stockholders (Magee on Banks and Banking, 2 Ed., p. 109, Sec. 103), but are also responsible managers of its business and operations and invested with full power of selection and appointment of the officers and agents to conduct its affairs. The control, supervision and conduct of the business of a bank is lodged in its board of directors as a collective body. The individual directors are not officers of the bank and have no power individually to control its management. To do this, they must act as a board, in which capacity they have plenary power to act for a bank, subject to the limitations of its charter and the rights of its stockholders. While the office of the bank director is generally gratuitous, it is never a sinecure."

If directors would actively concern themselves in their bank's affairs, live up to their obligations and perform their full duty, there would be few bank failures.

BANK FAILURES

THEIR CAUSES AND REMEDIES

An address delivered before the Twenty-Second Annual Convention of the National Association of Supervisors of State Banks, held at Denver, July 17-19, 1923, by E. F. Anderson, Chairman of the Board of Bank Examiners, State of Mississippi. (Used by permission of Mr. Anderson.)

How to safeguard the depositors' money under all of the conditions of business enterprise has ever been a subject of vital importance to the economic welfare of every state

and nation. And throughout the periods of development of the business structure of the several states and of the nation, much progress has been made toward safety in banking practice, both in the methods adopted in the conduct of banking and in the laws under which the banks operate.

Methods of supervision have likewise measurably improved, in the meantime keeping pace with the improvements in banking practice and legal limits imposed. The most fruitful causes of bank failures have evoked corrective measures adopted and overhauled at the dictation of experience. But the question of safeguarding the depositors' money will ever remain a vital one. And no minimum should be set as the standard of excellence in results obtained, even though the minimum be a constantly narrowing one.

In this discussion, I will speak primarily from practical experience gained in my nine years' service with the State Banking Department of Mississippi. My development of this subject may be somewhat restricted as I am including in addition to my own experience only the general causes of bank failures in the whole field of banking, and not special causes confined to certain sections of the country and arising out of special and unusual conditions. However, I feel confident that the cause of bank failures in my own state are fairly representative.

As I see it, the causes or occasions of bank failures may be summarized as follows:

First: The One-Man Bank

This characterization, I take it, is thoroughly understood by all of you. The great majority of banks, national and state, are located in the rural districts, or in the small country town. The one-man bank flourishes to a much

greater extent in these environs than in the active commercial and industrial centers. Usually directors of this character of bank are men not active in business affairs, and to many of them it is often inconvenient to attend frequent meetings of the board. The directorate may be composed of farmers or planters, the small merchant, the local attorney—all average citizens of the community. The three chief reasons for the inactivity of such a board of directors, I find, are as follows: First, there is a certain inconvenience incident upon attendance of the meetings. Second, the fear of offending the active officers of the bank in taking the initiative in any administrative program. Our law requires a quarterly examination of the bank by directors. It is expected and required that a report of such examination be filed with the department. We find this one of the most difficult tasks to have performed. In fact, when performed, it is usually done perfunctorily and without accomplishing in many instances what is desired.

We have adopted the plan of placing in the hands of each director an analysis of the condition of the bank following each examination. By this means, we do at least partially acquaint him with the condition of his bank, directing his attention especially to the weak points of administration and calling especial attention to his responsibilities.

The third reason for the One-Man Bank is that in many instances there is a real desire on the part of the active officer to take over all of the honors without a thought of the safety insured by joint consideration and judgment. His prime object is not a constructive administration but to satisfy his own desire for self-promotion, or for unbridled control and the power that goes with it, including so often the secret and fraudulent use of the funds of the bank.

This program of administration gives every opportunity

for a weak or unscrupulous official to wreck the bank, if through his personality he has been enabled to attract deposits, or to prevent the development of the institution and of the community owing to the lack of confidence imposed by the community in such banking practice.

To my mind, there is no greater hazard in banking than under the One-Man Control. This is the real vital point upon which we must concentrate our efforts. It is here that the indifference of the directors must be combatted. No remedy seems at hand, and probably this one cause of bank failures will continue the most fruitful throughout our banking experience. The best probable corrective, as I see it, is constant vigilance and prodding on the part of those in charge of supervision of the Banking Laws.

Second: Inactivity of Directors, or Failure of Directors to Administer the Affairs of the Bank

In a discussion of the One-Man Bank, it naturally follows that there must be a charge made against the directors, for there can be no One-Man Bank with an active and alert Board of Directors. There is, therefore, no reason for treating this as a separate and distinct cause of bank failure except that such treatment furnishes the opportunity to emphasize my belief in the fundamentals of banking. To my mind, the first requisite to constructive and safe banking practice under any system of administration, whether state or national, is active participation and control by directors. This is the crux—the heart of safe banking. Almost, I would say, this is the full answer. All other reasons for failures are subsidiary to this one. The bank fails for this, that or other reasons, because of the recreancy to their trust of the Board of Directors. To my mind the safety and permanence of any banking institution, large or small, wherever domiciled, or under what conditions of the

time, adverse or prosperous, is insured if under the active control of a board of directors honestly giving the best that is in them to their conduct of the bank. The crook is detected before he has gone too far, and the improvident manager checked before the bank is wrecked, provided the directors do their duty.

Third: Public Deposits

The Banking Act of Mississippi was adopted in the spring of 1914. Prior to that time we had no banking laws, no supervision. The depository laws had been developing for many years, especially, of course, for the protection of Public Deposits—state, county, drainage and municipal. These laws were then in keeping with the needs of the time. They were a protection for *one class of deposits*. But when the Banking Act with the guaranty feature was passed, the Depository Laws were not amended so as to harmonize with the Banking Act written to protect *all deposits*. We have not been able to have the Depository Laws amended. There is a considerable sentiment in favor of special protection of public deposits, and this protection comes at the expense of the bank and the common depositors.

The failure to harmonize by legislative enactment the discordant element in the two laws resulted without doubt in one serious weakness, so far as legal provisions are concerned, in our guaranty feature. There is no limit to the amount of public deposits a bank may receive, except the general provision that a bank cannot carry continuously for more than six months deposits in excess of ten times its capital and surplus combined. Again under the competitive provisions of the Depository Laws, the rate of interest can be run up to a point that creates hazard. The Board of Bank Examiners is required to set the rate of interest to be paid by state banks upon all classes of inter-

est-bearing deposits, which include public deposits. As the Depository Laws provide no maximum rate of interest to be paid for Public Deposits, and as the state and national banks are completing, as systems, and as banks, and as we have no check on the national banks, we are forced to set the maximum rate a state bank may pay on Public Deposits high in districts where there is national bank competition, to prevent discrimination against state banks. There is no rate restriction to national banks.

The maximum rate where there is no competition of national banks is set by our Board at 4%. This rate is given prominence in the Banking Act itself, the Law stipulating that no deposit is guaranteed that bears a greater rate of interest than 4%.

The two principal danger points as is indicated on the surface are, first, no limit to the amount of Public Deposits a bank may accept, and, second, a probably excessive interest rate. I regard any rate upon Public Deposits in excess of 2% as excessive. Every supervisor of banks knows of the contingent danger of a large deposit, whether individual or otherwise. A wise control of such fund would call for an investment in liquid paper of a portion, and the maintenance of a rather large reserve. But such funds are not always so handled. And where not so handled, a crisis can easily arise. To such banks a considerable, or even a moderate over-expansion, as was the case in 1919, 1920, and 1921, would result in disaster.

As a remedy we would eliminate competition, set a low maximum interest rate to be charged all banks, state and national, for each character of Public Deposits, apportion such funds to all of the banks in the ratio of capital and surplus of the bank to capital and surplus of all banks, and establish a special reserve requirement.

Of the twenty-one banks in Mississippi which have failed

since 1914, as many as one-third of these would probably have survived had it not been for the mire of Public Deposits.

Fourth: An Excessive Loan Limit, and No Restriction to Borrowing

There is a certain or definite hazard to the bank operating under any system which does not place a reasonable limit upon the amount of the loan the bank may make to individuals, firms, or corporations. Our loan limit is 25% of combined capital and surplus. Our only period of trouble experienced in Mississippi since the enactment of our Banking Law was that period following the close of the war. We had only five bank failures prior to the fall of 1920.

We are confident that the degree of inflation of our state banks would have been measurably reduced had our loan limit been more in keeping with the generally recognized safe limit. And granting that a lower limit may not have restricted the over-expansion of those banks which knew no safe bounds in extending credit during that period, it is the consensus of sound banking opinion that a given volume of loans becomes sounder in value as the aggregate of small and diversified loans approach the total volume.

Equally hazardous, for the same reasons as is an excessive loan limit, is the failure of any system to limit within reasonable bounds the amount a bank may borrow. In addition to the fact that our law provides for what we regard as an excessive loan limit, there is no restriction whatever to the amount a bank may borrow either by rediscounting or by Bills Payable. To my mind, the power to borrow in an unlimited amount by rediscounting is as hazardous to a state bank, not a member of the Federal Reserve System, as is the privilege to borrow in unlimited

amounts under Bills Payable. The result of either is expansion.

It was this defect in our Banking Law which created the necessity for a reconstruction through which some of our banks have had to pass in the recent years, and on account of the lack of these safeguards that some of our failures occurred. Those of you who have had the difficult task, as we have had, not only of combatting the serious conditions now happily past, but of administering laws not especially provided for such periods, can appreciate, I take it, the grind and wear and tear incident to such service.

The remedy is clear, and will certainly be made available now that the experience we have gained in that period of severe test has indicated clearly that safeguards, automatically limiting over-expansion, must be provided.

Fifth: The Bank Crook

Is there a more insidious foe than the bank crook? We can be sure of making fairly safe provisions for the elimination of banking waste from all other sources, however and wherever it occurs. We can instruct the ignorant but honest man and show him the safe way. And we can hold within reasonable bounds by legal restrictions and by rigid and frequent examinations all other tendencies, of whatever character, toward banking hazards, and materially restrict bank fatalities, but how shall the bank crook be circumvented?

Candidly, I am frank to say that we have been unfortunate in our experience with the bank crook. We could show a worthy record of achievement in the safe conduct of banking in Mississippi had it not been for this insidious foe. I am glad of this opportunity afforded to compare notes with you. I want to know if we have a bad record, a record above the average of fatalities from this cause. I

have, in a way, been humiliated, and in casting about for the probable causes, have wondered whether or not our system of guaranty of bank deposits holds out a more inviting field for the dishonest banker. Is there something in the psychology of the situation thus created that releases the restraint against wrong doing and develops the yellow in the man?

Certainly it is that if our failures from this source are within the average, the banking profession attracts more disreputable members than does any other business enterprise. And if our losses sustained from this one source run no higher than the average, this hazard is so great, and so disconcerting and so prejudicial to the banking business as to justify some concerted action by the banking systems, state and national, to develop a systematic plan of action which will make it more difficult for the dishonest banker to ply his trade.

Of course, it will be understood that any loss I refer to as having been suffered on account of bank failures in Mississippi is absorbed by the state banks, and not by the depositors. For the depositors are paid whether the failure is occasioned by the fraudulent use of the funds of the bank by an official, or is brought about by any other cause.

Our experience may be unusual. And probably a failure in Mississippi, to the supervising authorities and to the bankers who pay the bill of loss is magnified more than is the case in those states where the guaranty plan does not obtain. Our record of failures from this cause will interest you if for no other reason than a basis of comparison with your own. Here it is:

Our Banking Law was enacted in March, 1914. Our system of guaranty of deposits is mandatory. All banks were required to come under the guaranty provisions of this law by June 1, 1915, or go out of business. We had

five failures up to April 23, 1917, the first occurring in February, 1916. Since October 14, 1920, we have had 16 failures, making a total of 21 failures in nine years of operation. Of the 21 failures, 7 of these were caused by dishonest bank officials. These seven bank failures will cost the guaranty fund as much as \$560,000.

Sixth: The Ignorant and Untrained Banker

In the highly specialized business of banking there is no place for the untrained official or directing body, those not acquainted with the fundamentals of safe banking. It is often the case, however, that men possessing no qualifications, either of native ability or of education, are in charge of banking institutions. Banking under such management reaches the point of hazard when the active officials or governing body attempt more than a mediocre rôle.

The rural districts are to a greater extent than are the commercial centers afflicted with this character of banking. This character of bank official is frequently found in the bank that is organized primarily for the convenience of the small community in which it is located, and in the bank organized to create a position for some ambitious individual, chosen without regard to his qualifications.

We are all of us acquainted with the bank so officered. The rural districts exist even in the highly developed industrial and commercial states. The same difficulty is experienced in all rural districts in obtaining the services of competent and trained officials. The compensation is inadequate and the environment is not attractive.

Happily, owing to the conditions under which this character of bank operates, the aggregate of waste from this cause is small compared with the amount of loss sustained from other bank failures. Probably the best remedy to apply is to establish a larger minimum capital and surplus

requirement. Our minimum is \$10,000 capital. I am of the opinion that this minimum should be raised. As a corrective measure, we have adopted an educational program in which we attempt to develop the officials by instructing them in the fundamentals of banking.

Seventh: The Wild Cat Bank

This characterization, I believe, is used as descriptive of that method of banking practice which acknowledges no bounds or limits or restrictions either as regards a course of conduct established by experience as safe, based on an understanding of the inexorable economic laws; or as regards a course of conduct in conformity with the laws under which the bank operates.

This is the bank whose officials either refuse to be disciplined or to whom supervision is abhorrent. It is one whose officials can learn nothing from the experience of others or from their own experience. In fact, it is the one which is a law unto itself.

I would not say that we have had any failures of banks of this character, but this type of banking practice has been a contributory cause of some of our failures. You have under your charge a list of banks marked for frequent examination. In this list I would say that this character of bank predominates. It does on ours. This program indicates that our experience has taught us that frequent examinations are necessary. And they do have some effect. In this manner only can the condition of the bank be appraised at any time for a determination by the Superintendent or other supervisory authorities of a program of discipline.

Eighth: Use of Funds of Bank by Officers and Directors

There has not yet been accepted by all governing boards

of banks the principle that the officers and directors are the trustees for the safe keeping of the depositors' money. Rather, some banking corporations are promoted by a group of men primarily, it seems, for the purpose of availing themselves of funds of the bank, and with such funds they finance themselves on a basis more liberal than they can use in the open market.

Such use of a bank by its directing officers is being restricted by advanced laws which are based on the principle that it must be made more difficult for the officers and directors of the bank to obtain use of its funds than it is for those having no financial interest in the bank. Our law requires the officer or director desiring to borrow from his bank to file an application with the board of directors for such loan. This application is passed upon by the directors and if the loan is approved, the matter of the application and approval of the loan must be recorded in the minute book. The principle of the law is, we think, sometimes evaded, or in fact the law nullified, in the granting, too freely, by the board of directors of accommodation to its members. The members of the board reciprocate in voting loans to each other. We have adopted a test here. We take exception to loans of officers and directors if we are convinced that they are made on a more favorable basis than could have been acceptable in the open market.

Ninth: Inadequate Laws and Infrequent Examination

Banking laws come by force of necessity and impose conditions under which the banks are privileged to operate. Departments with supervisory authority, are provided for the enforcement of the laws. Our banking laws are still imperfect, and the hazards in banking will continue as long as there are defects in the law. Defects either in the failure to have embodied in the law provisions limiting within

narrower bounds the power of the directing board, or defects in principle of some existing laws. For some theories have been embodied into law, here and there, and it may take general acceptance of such theories by all states, and a generation of trial to determine whether these theories are consistent with sound banking.

I have already called your attention to some points of weakness in our banking laws which very probably were the direct cause of some of our failures. The same can very probably be said of the banking laws of your state. And the purpose of these discussions at these conventions is to locate the weak spots in our system of laws and to unify as nearly as possible the laws governing the operation of state banks.

Supervision and examination are as important factors in the prevention of bank failure as are sound banking laws. The law must be enforced to be effective. It therefore follows that an adequate administrative force must be provided for. That was not the case in our state. We had no banking laws and no character of supervision until 1914. And at that time there was more than three hundred state banks operating in Mississippi. Our banking law provided for the guaranty of bank deposits.

In the face of these conditions, our banking law provided for the following administrative force. Three chief examiners, who constituted the Board of Bank Examiners at a salary of \$3,000 per year. Three assistant bank examiners at a salary of \$1,800 per year, but with the condition that if the assistants were used that each bank examiner would contribute one-fourth of the salary of an assistant, the balance being paid out of the funds of the department. An office assistant was also provided for at a salary per year of \$1,800.

This was a policy of false economy, and from that policy

the state has suffered. And this policy was not at all necessary for the rate of assessment upon the banks for the expense of maintaining the department was sufficient to have provided an adequate force. Partial relief was obtained when the law was amended in 1916, allowing each chief examiner an assistant whose full salary was to be paid out of the maintenance fund. We continued with this force through the balance of the war period and through the period of inflation following the close of the war. We had no relief in those years of re-adjustment. Not until the spring of 1922 was provision made for a sufficient number of examiners to make as many as two examinations per bank per year.

In the face of all of these conditions our bank failures have been less than could have been reasonably expected, and the banking situation in Mississippi today is fundamentally sound. Yet who will doubt if we had had an adequate administrative force from the beginning the number of failures would have been materially reduced.

Tenth: Periods of Business Depression

There probably has been no more frequent cause of bank failure in the development period of this country than the recurring periods of financial depression. These periods are not the accompaniment of great upheavals, such as the great World War, but were occasioned by the frequent necessity for a breathing spell in our feverish activity in developing our commercial, industrial and agricultural supremacy.

When activity had for the season gone too far and an overabundance of raw and manufactured products clogged the wheels of industry, and when no foreign market was available to absorb the surplus and with no provision in the business structure or by legal arrangement for tiding

over until the next swell tide of prosperity carried the country on to a greater period of development, there was stagnation and tremendous economic loss.

Happily, our business structure has been put upon a more solid basis and our national banking laws have been so adjusted to the needs of the growth and development of the country, by pooling the banking resources, as to severely reduce losses resulting from this cause. And business panics **can** now probably be entirely eliminated when equitable provisions are adopted for membership of state banks into the system, on the basis of profitable operation.

It is unnecessary to say that the business recession following the close of the war and consequent shrinkage of the value of commodities was a contributory and in some instances a decisive cause for our bank failures of that period.

If I were called upon to preach on this subject I should select for my text the biblical observation, evidently intended for bankers, "In a multitude of counsellors there is safety." The joint judgment of three men is more likely to be sound than the judgment of one of the three. The bank with a single man in control has the benefit of the judgment of only one man when he is entirely honest. And such bank also runs the risk of this one man left unsupervised, yielding to the daily temptation of false opportunity.

If I should be required to state what different management would have forestalled the failure of each bank we have liquidated in Mississippi since 1914, I should say that a greater number of persons in each instance should have taken an immediate part in the bank's affairs.

Speaking out of my own experience with specific cases of failure my judgment is that changes in the laws should be aimed primarily at the insuring of the activity of a greater number of men in the business of each banking institution.

How this is to be accomplished I am not prepared to say. But the law should be so changed as to make it impossible for a man to carry the title of director unless he actually directs. Men should not be allowed to act as decoys merely. Nor should they be allowed to retain positions whose duties they are incapable of performing.

Also it might be suggested that every director should be required to own not less than a certain percentage of the stock; that no loans above a fixed limit should be made without the written assent thereto of a majority of the directors; that loans in large amounts should be passed upon by the board in session; that no bills payable should be made without the action of the board; that no officer or director should be privileged to borrow from his bank. Let the laws be changed to embody such regulations and give the superintendent of banks the power to compel the observance of them. Let him have the power to remove the inattentive or inactive director or an active manager who ignores the limitations upon his own authority. Regulatory bodies instead of criticising and correcting what *has been done* should have the power to *prevent* what is likely to *happen*.

Men do not often organize to rob a bank from the inside. The crook takes nobody into his confidence. He works alone. He usually begins to work and adopts his plan after he finds himself alone. Regulations must be so framed and enforced as that no man in a bank will ever find himself able to act in a vital matter without the knowledge and concurrence of two or more others. The seven corrupt failures in Mississippi would have all been prevented by the active participation in the bank's affairs by their respective boards.

My suggestions above are tentative. Whether upon mature consideration I should approve them myself, I

cannot now affirm. But of this I am convinced and I am willing to affirm it, or even proclaim it:

Every new regulation, statutory or otherwise, having for its ultimate purpose the prevention of bank failures, must operate upon and through the bank directors. They must give more of their time and attention, and if they do not give it, they must be required to do their duty by some official authority.

The best system is that which insures participation in the bank's vital affairs by the greatest number of men.

CHAPTER FIVE

DIRECTORS' MEETINGS

MR. HUGH McCULLOCH, the first Comptroller of the Currency, in 1864 addressed a letter to the managers of national banks, so plain, yet so profound and wholesome, that it is here given in full:

“The business of a bank should be carefully and promptly conducted. The books at the close of business each day should exhibit the amount of cash on hand, and the exact condition of the bank. In large banks all the books should be balanced daily, in small banks, weekly, or oftener; and as often as every quarter a careful examination of its affairs should be made by committees of the directors appointed for this purpose, and a report of the result of these examinations entered upon the minutes.

“The officers of the bank, other than the president, should be appointed to hold office during the pleasure of the board, and bonds should be executed accordingly. This will obviate the necessity of requiring annual bonds from these officers, and will prevent the recurrence of a time when they will not be under bond. Presidents being annually elected or appointed will, of course, be required to give annual bonds, and whenever an official is reappointed a bond should be required of him.

“No loans should be made that are not secured beyond a reasonable contingency. Nothing should be done to foster and encourage speculation. Facilities should be given only to legitimate and prudent transactions. Discounts should

be made on as short time as the business of the customer will permit, and payment of all paper at maturity should be insisted upon, no matter whether the bank needs the money or not. A note or a bill should never be renewed merely because the bank may not know where to place the money with equal advantage if the paper is paid. In no other way can the bank properly control the discount line, or make it at all times reliable.

"Distribute the loans rather than concentrate them in a few hands. Large loans to a single individual or firm, although sometimes proper and necessary, are generally injudicious, and frequently unsafe. Large borrowers are apt to control the bank and when this is the relation between the bank and its customers, it is not difficult to decide which in the end will suffer. Every dollar that a bank loans above its capital and surplus it owes for, and its managers are therefore under the strongest obligations to its creditors, as well as to its stockholders, to keep its discounts under its control.

"A bank should treat its customers liberally, bearing in mind that it prospers as its customers prosper, but the customers should never be permitted to dictate its policy.

"If the propriety of discounting an offering is doubted, give the bank the benefit of the doubt and decline it. If the bank has any reason to distrust the integrity of a customer, close his account. Never deal with a rascal under the impression that you can prevent him from cheating you. The risk in such cases is greater than the profits.

"In business know no man's politics. Manage the bank as a business institution, and let no political partiality or prejudice influence your judgment or action in the conduct of its affairs.

"Pay the officers such salaries as will enable them to live comfortably and respectably without stealing, and

require of them their entire services. If an officer lives beyond his means, dismiss him; even if his excess of expenditures can be explained consistently with his integrity, still dismiss him. A man cannot be a safe officer of a bank who spends more than he earns.

"The capital of a bank should be a reality, not a fiction, and it should be owned by those who have money to lend, and not by borrowers.

"Every banker under the national system should feel that the reputation of the system, in a measure, depends upon the manner in which his particular institution is conducted, and that, as far as his influence and his management extend, he is responsible for its success. It should be the chief aim, therefore, of the managers of the bank, to make their respective institutions strong, not only to keep their capital from being impaired, but gradually to create a surplus that will be a protection to their capital and to their creditors in the trying times that will sooner or later come to all banking institutions. There are few items that will have a better look upon the balance sheet, none that is better calculated to give aid and comfort to the managers of a bank, and to secure for it the confidence of the people, than a large surplus fund. Create, then, a good surplus, if even for a short time the stockholders have to be kept on short commons in the way of dividends to do it.

"Pursue a straightforward, upright, legitimate banking business. Never be tempted by the prospect of large returns to do anything but what may be properly done under the National Currency Act."

Few, if any, banks are all that they should be unless the directors are active and meet regularly, giving the bank such attention as may be required to direct its policies. There are far too many instances where directors are active in a sense, attending board meetings regularly, and yet

their banks suffer from lack of directoral control; the policies of the bank being dictated by some active officer and the directors being mere "figure heads," voting aye or nay on any matter proposed by the controlling factor in the bank, and signing on the "dotted line."

Any board of directors that desires to actually control the policies of its bank must meet regularly and at intervals not too infrequent, for otherwise it can hardly be advised of what the active officers are doing nor of the various matters which should have its official attention.

The larger city banks have various committees—executive committee, finance committee, loan committee, etc., which look after the various activities of the bank and report to the board of directors. These committees meet regularly, in many instances, daily, and actually give the matters over which they have charge attention. But in the smaller institutions, while committees are desirable, so that prompt action can be had, especially regarding loans and discounts, the board as a whole should give attention to most of the bank's affairs and direct its policies.

A regular meeting day and hour should be set for each week or month, as the case may be. The time chosen should be for such an hour that there will be no cause for undue haste, and which will be most convenient for all members of the board.

In Chapter Two, "Schools of Instruction" for bank directors was referred to. At the meetings held by the Bank Commissioner of Arkansas a "Suggested Order of Business for Monthly Meeting" was discussed.

One of the regulations of the Department is and has been, that the directors meet once each month and that they go over the affairs of the bank and make a written record of their actions in a book kept for that purpose.

SUGGESTED ORDER OF BUSINESS FOR
MONTHLY MEETING

1. Call to Order—noting quorum.
2. Reading of "Minutes" and approval and signing by president and secretary.
 - (a) Report of Committees; Examining Committee, Other Committees.
 - (b) Report of Directors, instructions previously given.
3. Report of President and Cashier.
 - (a) Statement of bank and comparative statements with other months and years.
 - (b) Condition of clerical work. Errors reported by Examiners.
 - (c) List of Employees and Salaries.
 - (d) Are they paid enough salary, and are they living within their salaries?
4. Loans.
 - (a) Approving of new loans in writing.
 - (b) Policy in re future new loans.
 - (c) Examination of past due loans, extensions and renewals.
 - (d) List of overdrafts and discussion.
 - (e) Discussion of special loans in note case.
 - (f) Excess Loans.
 - (g) Loans to Officers and Directors.
5. Bills payable and Rediscounts. Authority to borrow.
6. Surety Bonds of Officers and Employees, and who holds them.
7. Communications.
 - (a) Communications from Bank Commissioner.
 - (b) Discussion.
 - (c) Reply dictated by Board of Directors and signed by all of them.
 - (d) Other communications.
8. Discussion in Cashier's absence.
9. Expense Account—Book showing distribution of expenses.
 - (a) Compared with other years and months.
 - (b) Compared with bank's income.
 - (c) Taxes.

10. Dividends.
 - (a) Losses.
 - (b) Doubtful Paper.
 - (c) Surplus and Undivided Profits.

Far too often a board of directors will meet having little idea what matters should come before it. Therefore, a discussion of "Suggested Order of Business for Monthly Meeting" will be undertaken.

1. Call to order by the presiding officer.
2. Roll call, noting the names of those present and the absentees. Always embody these names in the minutes.
3. Reading of minutes of previous meeting.
Correction and approval of these minutes; they should always be signed by the presiding officer and the secretary.
4. Old business.
 - A. Reports of committees if any outstanding. The reports should be written into the minutes.
 - B. Report of president or cashier on instructions given at previous meetings. Write reports into minutes.
5. New business.
Under this should come the cashier's report of the Bank's condition.
 - A. Statement of bank and comparative statements of other months and years. Copy should be furnished each director.
 - B. Condition of clerical work.
 - C. List of employees and salaries. Are the employees paid enough, and are they living within their incomes?
6. Loans.
 - A. Approval of new loans. This approval should be shown in the minutes, and the approval should be written on the discount register, each member of the board present signing the approval. Should there be any loan which is not approved by any member of the board it is his duty to note on the discount register his disapproval and also have his disapproval noted in the minutes.

- B. Policies in reference to new loans. There are times when banks are not in position to make new loans. Too often directors do not realize this, and continually approve new loans and consent to making new loans, when the bank is not in position to make them.
- C. Loans to officers and directors. Whenever loans are made to officers or directors they should be approved by special resolution of the board of directors which should be embodied in the minutes of the meeting at which such approval is made.
- D. Examination of past due loans. The cashier should be required to bring before the board all past due paper. Special instructions should be given the active officers regarding the handling of this class of paper and these instructions made a part of the minutes. It is equally important that all loans which have been extended by interest payments be reviewed.

*"Notes past due are always subject to criticism. Borrowers should be given to understand that when a note is due if not paid new arrangements must be made for continuing the loan. In case of mortgage loans, extension agreements should be executed if the loan is to run beyond the date of maturity. Demand notes should be renewed or paid off after six months. Directors can well serve the bank by close supervision of past due paper. The general rule should be to renew the desirable, collect the doubtful, and charge off the desperate."

- E. Excess loans. Something no bank is justified in having as they are in violation of law. These require the constant attention of officers and directors.

†"The way to prevent excess loans is to avoid making maximum loans. It happens too frequently that maximum lines of credit force excess loans. Maximum loans are undesirable and sometimes

*"Pointers, Suggestions and Model By-Laws," Banking Department of Illinois.

†"Rules and Regulations," Banking Department of Oregon.

dangerous. Officers and directors should absolutely refuse to authorize or approve excess loans."

- F. Discussion of special loans. Usually this would be covered in the above.
- G. Overdrafts—the most unsatisfactory form of loan. A list should be furnished by the cashier which should be reviewed by the board.
- 7. Bills payable and rediscounts. Are they authorized by the directors and have resolutions been made a part of the minutes?
- 8. Expense account.
 - A. Compare with other months and years.
 - B. Compare with bank's income.
- 9. Communications.
 - A. Reading of communications from banking department which should be made a part of the minutes. Replies should also be made a part of the minutes.
 - B. Other communications.
- 10. General discussion.
 - A. Surety bonds of officers and employes and burglary and other insurance.
 - B. Discussion in the absence of active officers.
 - C. Other general discussion.
- 11. Dividends.
 - A. Have losses been charged off?
 - B. Have reserves been made for doubtful assets?
 - C. Have reserves been made for depreciations and taxes.

*"No bank should consider declaring a dividend to stockholders until ample provision has been made to absorb all determined or probable losses and then only for the net undivided and unappropriated profits of the bank.

"Directors cannot legally declare or authorize dividends until all bad or doubtful assets have been removed or properly reduced to the actual cash value.

"No board of directors should authorize or pay dividends until they are reasonably satisfied, with

*"Rules and Regulations," Banking Department of Oregon.

a clear conscience, that the assets of the bank which they represent are worth one hundred cents on the dollar.

"Dividends improperly or illegally declared may impose the burden of assessing the stockholders. This is the most essential thing to be avoided."

One of the most important, yet most grossly neglected, things concerning board meetings is the minute book. If it is important for the board to meet and take official action on matters coming before it, surely it is equally important that full and complete minutes of their actions be kept, for the minutes are the record of the board's official actions, and unless such record is carefully kept, what proof or evidence is there that any action has been taken?

MINUTES OF DIRECTORS' MEETINGS

(Sample Form)

Minutes of the regular (or special) meeting of the board of directors of the Peoples Bank held at the banking rooms in the city of Huron, State of Arkansas, on the fourth day of June, 1924, with

President, James Grace, presiding.

Directors present: G. W. Tripp, S. A. White, John Adams, Earle Henry, and H. B. Smith.

Directors absent: F. P. Green.

The minutes of the meeting held on the second day of May, 1924, were duly read, approved and signed by the President and Secretary.

The report of the Auditing Committee was read in full. After discussion, on motion duly made and seconded, same was approved and made a part of the minutes of this meeting. The Secretary was ordered to file the report for future reference.

The Cashier reported that, in accordance with instruc-

tions given at the meeting held on the second day of May, suit had been entered against John Jenkins to recover on his note for \$1,000.

The Cashier presented each director with statement of the bank's condition and called attention to the bank's satisfactory condition.

All loans made for the period beginning May 2, 1924, and ending June 3, 1924, as the same are listed on the note register and numbered from 9,437 to 9,506, both inclusive, which list is hereby referred to and by such reference made a part of these proceedings, were read, examined and approved by directors, Grace, Tripp, White, Adams, Henry and Smith voting aye and no nays.

The Cashier reported the following investments:

Ames County Warrants.....	\$ 1,500.00
Road Improvement District No. 4	
6% bonds	10,000.00

(Note—Where the investments are too numerous for entry in the minutes a separate schedule may be prepared for approval of the board and referred to as a part of the minutes. The schedule should then be filed for convenient reference.)

The following resolution was then adopted;

RESOLVED, That the application of Director G. W. Tripp for a loan of \$2,500 be approved and that the Cashier be instructed to make the loan.

The directors reviewed all past due notes and gave the cashier the following instructions:

Collect the following notes:

James Earle	\$500.00
Henry Jinks	375.00

Renew the following notes:

E. J. James.....\$1,000.00

W. C. Carl..... 250.00

Enter suit on the following notes:

C. D. George.....\$300.00

The Cashier presented a list of overdrafts which was reviewed by the directors.

The expense account for the past month, totalling \$875.62, was examined and on motion duly seconded was approved.

(Complete and detailed minutes referring to all matters presented should be prepared. All instructions or decisions of the board of directors should be written into the minutes in detail. RESOLUTIONS ADOPTED MUST BE ENTERED IN FULL.)

There appearing to be no further business, the board adjourned.

JAMES GRACE, *President.*

Attest: H. B. SMITH, *Secretary.*

After all loans referred to in the minutes have been read to the board of directors, the following entry or notation should be made on the note register on one of the last pages containing the loans approved:

All loans listed herein from May 2, 1924, to June 3, 1924, and numbered 9437 to 9506, both inclusive, are hereby read, examined and approved.

JAMES GRACE

JOHN ADAMS

G. W. TRIPP

EARLE HENRY

S. A. WHITE

H. B. SMITH

When a board of directors meets regularly, giving the time necessary to seriously consider all matters presented to it, that board is, almost invariably, active to the degree that it governs the policies of its bank.

An active board of directors is the best guarantee of the safety and success of any banking institution.

CHAPTER SIX

BANK SUPERVISION AND EXAMINATION

THE right to examine banks is a part of the police power of the State. The subject of supervision and examination is so comprehensive and far-reaching, embracing so many problems that must be developed with each individual examination, that only the salient points can be covered in this chapter.

W. K. Kniffin, Jr., in his book, "The Practical Work of a Bank," expresses the thought that the purposes of a bank examination are to see:

1. That the bank is solvent.
2. That it has, as claimed by it, assets of certain value.
3. That its methods are modern, its management conservative, and its policies sound.
4. That the laws regulating the bank are being complied with.

Briefly, the ultimate end and aim of an examination is to protect the creditors and stockholders from losses due to unsound banking practices.

The purposes of State Banking Departments are well set out in the following:

*"The objects and purposes of this department will be to strengthen the banking business in this state and require a strict compliance with the laws, rules and regulations; to require elimination of undesirable and dangerous practices;

*"Rules and Regulations," Banking Department of Oregon.

to encourage the establishment of policies which are sound and consistent; to assist in revising methods of accounting and filing and replace them, so far as possible, with modern methods which will meet the requirements of the respective localities and provide both accuracy and dispatch in the transaction of business; to exercise the power and functions of the department; to properly safeguard and protect depositors and to invite and encourage a spirit of harmony and coöperation among all bankers in this state."

In practically every state the office of supervisor of banks is appointive. Grave responsibilities accompany the office, for to the supervisor is given the enforcement of the banking laws and the supervision of State banks. The same is true of the Comptroller of the Currency with relation to national banks.

It is the desire of every supervisor of banks to aid and assist the institutions under his supervision. Little does the public know of the vast responsibility placed upon the supervisor, the many perplexing problems which confront him, and the harassing experience he is required to endure.

The public knows little of the constructive work done by the banking departments of the country. Only the disasters are made public. There are hundreds of problems worked out by the banking departments for the benefit of bank creditors, which are so confidential in their nature that they cannot be made public.

Seldom does a supervisor close a bank except as a last resort. Sometimes he is criticised for not having closed a bank sooner, but many institutions have been saved by diligent work which under the law could have been closed. Thus thousands of depositors have been saved from loss and inconvenience of having their funds tied up in a closed bank.

The responsibilities of a banking department in dealing

with insolvent banks have been so well set out by the North Carolina Corporation Commission, that, with permission, the same is reprinted in full:

BANK SUPERVISION IN NORTH CAROLINA

By The North Carolina Corporation Commission

"The Corporation Commission of North Carolina welcomes the opportunity presented by the criticisms of the New Hanover County grand jury, and the fluke "presentment" story erroneously sent out by the Associated Press to present a view of its policy of supervision that the public should understand. In numerous grand jury investigations with reference to criminal violations of the banking law, the commission has placed at the disposal of grand juries its complete files of confidential reports of its examiners. These reports have disclosed ascertained conditions of insolvency. Those who never gave bank supervision enough thought to have an intelligent opinion about it have jumped to the conclusion that this was perfect proof that the commission was grossly negligent in performance of its duty if it permitted a bank to continue in operation after it became known to it that such bank was in any degree insolvent. That seems to be accepted by the uninformed as conclusive evidence of a serious failure to perform a serious public duty. Would these hair-trigger critics, who have never thought of but one phase of the question, accept on this point the opinion of the best world-round authority on bank supervision?

"The Hon. T. P. Kane was for thirty-seven years assistant comptroller of the currency, and guided the supervision and development of the most wonderful banking system in the world—the national banking system of the United States. In his volume, 'Romance and Tragedies in Banking,' after describing the approved methods followed by

the comptroller of the currency in dealing with national banks found to be insolvent, and describing how many patient months and sometimes years were given to the task of nursing such banks back to solvency, which could never be done if they were not permitted to continue in business, he says:

"For every failure of a national bank that has occurred during the existence of the system, a large number of associations have been saved from failure through the excellent work of the bank examiners and the intervention of the comptroller.

"The quiet and successful handling of such cases as the one described never becomes a matter of publicity, and this necessarily must be so, as publicity would defeat all efforts to straighten out a situation of this kind by creating alarm among the depositors, which would precipitate the very condition sought to be avoided. Consequently, the examiners and the comptroller's office never receive the credit to which they are justly entitled for the effective work done in nursing banks that are in a critical condition, or on the verge of dissolution, back again into a state of healthy financial existence.

"On the other hand, if the nursing remedies fail because of the incurable illness of the patient, no credit is given for the efforts made to save the life of the institution. The examiner and the comptroller are severely criticized and censured for having permitted the patient to live so long. and the effectiveness of the system of official supervision as a whole is generally measured by the failure in a few instances to accomplish the results desired and not by the numerous successes achieved in working banks out of desperate situations.

"There is about as much reason and justice in criticisms of this character as there would be in discrediting a noted

surgeon as unskillful who, in the course of his practice, operated successfully upon ninety-nine cases and unsuccessfully upon one, or in measuring the professional reputation of a regular practitioner by the occasional case that he lost in the course of a long practice instead of by the many that he successfully treated through the remedies prescribed.

"The failure of a bank is a community calamity, and while having to take the butt of criticism because, in the midst of the most rapidly changing economic conditions in a half century, it could not save some banks from honest failure, and could not prevent some men of criminal minds from committing criminal acts, the corporation commission has the satisfaction of knowing that by employing methods that are sound, if not spectacular, there are many communities in the state that have been saved from disastrous bank failures that would have resulted if the theories of those who criticize had been followed. This satisfaction is worth more to us than exemption from unthinking and uninformed criticism, and the commission will not be stamped by any amount of criticism from any source in changing its policy which it knows to be sound and in the public interest.

"We have passed through a period since the war when gold bricks became a standard article of commerce with many conservative buyers, and if in the rapidly shifting economic conditions of this period any other policy of bank supervision had been followed, there have been times when the whole industrial fabric of the state would have been shaken and widespread and irreparable loss would have resulted.

"The commission has in mind at this time one bank that examination disclosed would not have liquidated fifty cents on the dollar under receivership. It had a million of deposits and if closed on that report which disclosed insol-

veney, depositors in that community would have suffered a clear loss of half a million dollars and a half a dozen small banks would have followed it in failing. Through a gradual process its loans have been strengthened with security and it is regarded today as a solvent institution, under conservative management and serving its community. If the effort to save that bank had finally failed, the loss to its creditors would have been no greater than if it had been closed without an effort when its insolvency first became apparent.

"We would not be responsible for having closed that one institution, and made certain the loss of that half million dollars to its depositors, when there was a chance to work it out, in exchange for exemption from all the partially uninformed criticism that may be heaped upon us. In the troublesome recent years there have been many cases similar to this, and if any other policy had been followed, the deposit losses in the state would have been a hundred dollars where it has been one.

"As some evidence that our supervision of state banks has been creditable it might be said that in 1922 there were but four failures in North Carolina, while in Georgia there were 32 and in South Carolina 15.

"In the particular case which the New Hanover grand jury criticizes, the actual conditions were uncovered by our examiners and our banking department was so sharply behind them that they were driven into the national system, where they were permitted to go on with \$100,000 less of new capital than our department had demanded. In the interest of the public welfare, we appeal to the people who think and who have an equal interest in the public welfare, to give consideration to the phase of this question we have tried to present in this discussion, which can only be discussed in general terms, and let's have an end

of criticism that is meaningless and hurtful, even if intended to be in the public interest.

"Our banking department is entitled to the confidence of the public. It is performing its functions with intelligence and skill. Its activities have given us at last an effective, modern banking law, which is being efficiently administered, the one-man bank has been put out of business, and bank depositors are being given every protection that reasonable supervision can give. No system can be an absolute safeguard against criminal intent, but we have eight of those serving time in state's prison and the legal lines have been drawn tighter against future violations.

"The North Carolina Bankers Association was kind enough to constitute a representative committee of bankers to confer and coöperate with the corporation commission with reference to the most efficient supervision of state banks. We recently had the pleasure of a conference with this committee. In this conference, the committee learned that while the banking laws only require one examination a year, the corporation commission had used its general authority to require two examinations last year of more than half of the state banks. Members of the committee bore testimony to the thorough character of examinations being made and at the conclusion of the conference the committee advised that they had no recommendation to make for improving the service.

"The highly public purpose of making banks safe for depositors is not helped by unintelligent criticism of the department that is earnestly, intelligently and effectively working to this end, nor is the business of making banking unsafe for criminals helped when court officers turn on those who furnish the evidence, the coöperation, and in many cases, the special prosecuting counsel, to convict bank criminals."

The duties of the supervisor and the functions of the banking departments of the different states vary, but the general policies are well set out by the banking department of Oregon as quoted at the beginning of this chapter.

The position of supervisor of banks is one that requires much skill and experience. He must be a man of sound judgment with the nerve to back up his judgment regardless of pressure that may be brought to bear. But no matter how excellent, in every way, the supervisor may be, he cannot administer his office successfully without competent examiners.

One of the big problems of the supervisor is to obtain and retain competent examiners, for in most states the salaries are small, and about the time an examiner has held his position long enough to become proficient, some bank offers him a position and he accepts, for which he cannot be blamed.

The examiner, by reason of his office, stands in a peculiar and conspicuous relation to the bank department, the banks, and the public. It has been said that his greatest obligation grows out of this relation. Therefore, he should command confidence and respect, and merit the approval of bank officials and employes as well as the general public with whom, at times, he comes in contact.

The position of examiner is interesting and one that requires exceptionally good judgment if the examiner is to be successful in his work. He should be able to administer the law with justice and fairness; should be able to see and understand the banker's point of view; should not unduly exercise technicalities, but exercise his ordinary "horse sense" as to when to apply the preventive and to what extent.

He should not approach his examination as a detective looking for a criminal, but as a big-hearted individual look-

ing for an opportunity to help; to give a clean bill of health if deserved, but to discover the weaknesses, if any exist; to build up and not to destroy. In other words, the examiner should be constructive and not destructive in his policies.

Nothing should be overlooked in an examination, but too much stress is often laid on non-essentials at the expense of more important matters, which really affect the solvency of a bank. It is necessary for the examiner to pay attention to the little things, for it is often through this means that he is able to discover irregularities that seriously affect the condition of the bank.

In fulfilling his duties the examiner is called upon to face many perplexing problems, and is often confronted with situations that require the best judgment his experience affords. The work required of an examiner is at times very trying, and he is usually required to work long hours. The position is not altogether a pleasant one, nor is it entirely free from danger. The following copy of a report made by a bank examiner, will make this clear:

"I met Mr....., Cashier, about 8 o'clock in the morning and asked him how soon the bank would be open. He said at 9 o'clock. I told him I was with the State Banking Department and would like to get to work as soon as possible. He said he would open the bank for me in a few minutes. He took his little girl home, then came back to town, passed by me, and went on and opened the bank. In about ten minutes I went to the bank. His failure to ask me to go to the bank with him made me suspicious, and when I began to add the individual ledger I looked very carefully for changes in accounts and noticed that the total of checks, as charged on individual ledger for April 24th, was larger than the amount carried through cash book. I then asked him to give me the checks and deposits for April 24th and April 25th, and when I added

them I found that the total of checks for April 25th was \$500 less than the amount carried through the cash book. I had observed in adding the ledger a \$500 charge to the account of on April 24th, but the total of checks still in the bank paid on April 24th added the same amount that was carried through the cash book. So this charge against account could not have been properly made on April 24th, but must have been made on April 25th, as checks on that day totaled \$500 less than the amount run through the cash book.

"I then noticed that the currency had been charged and the total of checks on April 25th raised \$500 and total of cash lowered a like amount. I asked the cashier to produce the check against account, but he said her pass book had been balanced, and that he did not have the check. I told him to get the pass book; that he would have to explain this transaction to me. He said he realized that it looked bad, but he would get the pass book.

"In a few minutes he brought out of the vault a \$100 bill, his note for \$200 without date on it, some other notes, and a check on some one, all of which aggregated \$500 and wanted me to accept these in lieu of the \$500 check which had been posted to account. I told him to lay these checks aside and that I would look at them later, asking him why he did not tell me truth about the matter to begin with.

"In a few minutes he asked me if there was not some way to fix this up, that he did not want this to go into my report. I told him NO, that I was under oath, and to accept this settlement and say nothing about it, would be a penitentiary offense. I then checked up the bank accounts and found them in balance except an old returned check for \$12.00 which had not been credited to one of his correspondents. I then made out an affidavit that this was

the only irregularity in the bank, telling him that I was going to give him a chance to tell the truth, but that if he did not tell it, he knew what his failure would do for him. He resented this very much and said there were no irregularities in the bank, that he had a right to charge this amount against account. He then backed off toward the vault and began to curse me, and I walked over toward him, telling him that I had done him no injustice, he turned and walked into the vault, picked up a revolver and ordered me to change my report. I then tore up the affidavit which I had written for him to sign. He made me write up a statement at the point of a gun, that I had found all accounts in balance and no irregularities in the bank."

If every man were above temptation, the examiner would need only to take cognizance of a bank's assets. Since, however, this is not a fact, the examiner must direct a part of his attention to the verification of the bank's liabilities.

Unfortunately, many people think the banking departments audit banks. Many bank directors seem also to be of this opinion. As a general rule bank examiners do not make audits, nor do they pretend to do so in the course of a regular examination. True, the assets are verified and the liabilities are checked, but the examiners have not the time, nor the banking departments the funds, to make audits and the law does not intend that they should do so.

The examiner verifies every asset and every liability, employing such methods as he thinks expedient in testing the accuracy of each controlling account. It should be borne in mind that it is not the duty of the examiner, in most states, to make an audit of the bank under examination; there is unquestionably a clear distinction between an audit and an examination. An audit by a competent accountant is highly desirable for every bank, in addition

to the official examinations by the bank examiners, and if such audit is made the benefits are large and is one of the best assurances against defalcations.

Too often the public, and, in far too many instances, the directors of banks, feel that when the bank examiner has visited their bank it is a guarantee of the correctness of all accounts. Stop and think a moment. An examiner checks the controlling accounts of the bank as of the date of his examination. In the smaller banks it takes him a day or two to complete the examination, in the larger banks from a week to two or three weeks. It takes an auditor probably a week or longer in the smaller banks and longer, according to the size of the bank, in larger ones. With the time at his disposal, the bank examiner cannot do more than verify the controlling accounts in a most perfunctory way. Of course, if there is anything to indicate irregularities, it is his duty to satisfy himself. But he is primarily interested in the worth of the assets of the banks, and to these most of his time is given.

There are no thief-proof systems, or all banks would have them. But directors can throw around bank employees such safeguards as are known, and they owe it to their customers, their employees, and themselves to do so.

After each examination, if possible, a meeting of the entire board of directors should be called by the examiner, at which meeting he should go over every note, getting each director's opinion as to the makers, endorsers, security, etc., covering very carefully each note where there is a variance of opinion of the directors, and making a record of it. The attention of the board should be called to any infraction of law, or carelessness in observing its provisions. A free discussion of conditions is beneficial to both board and examiner.

The examiner must remember the disadvantages of dealing with older men of affairs. Occasionally a young examiner encounters a director or a bank official who probably was in the banking business before the examiner was born, and it is hardly necessary to say that it requires discretion and tact of the highest order to control and manage the situation without needless friction.

*"When examiners appear at your bank assist them in every way possible. If they criticise your methods or policies, please consider that this is intended for the good of your institution. This department dislikes very much to criticise. We prefer to commend freely every institution which we find in a satisfactory condition.

"Examiners have been instructed to make all examinations without fear or favor, but in all fairness to every bank. At the same time we expect every banker to be fair with the examiners. Put all your cards on the table face up. If you have difficulties we will assist you in every way possible. Do not try to cover your tracks.

"Examiners will be required to report every condition which is worthy of comment, or which may require consideration. If their report is one of criticism or adverse comment, remember that it is simply a report covering the facts as they have been found—the facts and conditions which you have established or created—and in every case the report submitted will receive such action as the conditions may justify or require."

The supervisor and bank examiners are the banks' best friends. Many banks might have been saved from closing their doors had the directors and officers "toted fair" with the examiner during his visit, or had they taken their problems to the banking department before it was too late.

You may fool the examiner for a while and get by but

*"Rules and Regulations," Banking Department of Oregon.

you cannot fool yourselves, and sooner or later your trouble will come to light.

Banking is so important and its effects so far reaching that many of the states, as well as the Federal Government, have seen fit to regulate the number of banks to be established in any community by giving the supervisor or a charter board, in the case of National Banks, the Comptroller of the Currency, discretion in the matter of granting bank charters. When this power is properly used, and unquestionably in nearly every instance it is so used, this discretionary power is for the good of all concerned, for with the broad knowledge of banking conditions which the authorities in power have, they often know better than the people in the community whether or not additional banking facilities are needed. After all is said, the proper test as to the necessity for banking facilities is not that it will furnish some one a job, but that it will fill a real public need and that there is sufficient business to sustain the institution.

There has been much discussion as to the advisability and soundness of permitting the organization of banks with small capital. A discussion of this will not be undertaken. Suffice it to say that many communities are served by banking institutions of small capitalization, which would be without banking facilities if larger capital were required. Many of these small banks are managed as efficiently as any of the larger ones. Unquestionably, however, too many small banks are organized in prosperous times which are unable to survive the "lean years." It is as essential for a bank to need the community as for the community to need the bank—there should clearly be enough business to enable a bank to make expenses and at least a small return, in the way of dividends, for the stockholders.

The question of control over the granting of charters for new banks is well set out in the following:

"All well-informed persons are now fully and keenly alive to the marvelous economic changes which the rapid industrial and commercial development of the nation in recent years has produced. New economic forces have been evolved, and the social relations of men have become complex and interdependent to a degree previously inconceivable. Numerous subjects which formerly were chiefly private, with only an incidental public aspect, have become social subjects, demanding regulation of a kind and to an extent which former conditions did not warrant. The business of banking is now clearly recognized as belonging to the latter class.

". . . whenever, through changed social conditions or otherwise, a business becomes essentially public in character, and assumes proportions, takes on features, or is attended by consequences which make free participation in it destructive of the ends for which it is pursued and a menace to the welfare of society, society, through its duly constituted authorities, may, in the absence of constitutional prohibitions, protect itself by limiting the right to engage in such business, as far as may be necessary to attain the desired security. Banks are incorporated in part for the beneficial purpose of providing safe depositaries for the people's money and credits. It would be paradoxical, indeed, if the right of individual liberty and property should require the state to go on incorporating banks in a given community until, through the certain operation of known economic forces, deposited money and credits would no longer be safe. The power to suppress monopoly and restore competition has never been doubted. The power is exercised for the public good, and so is justified. If the

results of unrestricted competition become pernicious as those of monopoly, the same suppressing power may be exercised, to the same end—the public welfare—and so be justified.” (Schaake v. Dolley, 118 Pac., 83.)

*“In eras of great commercial prosperity, the possibility of securing profitable business in dull times should be carefully weighed.”

One of the most stubborn problems before all banking departments is that of inducing directors to assume full responsibility, and give the proper attention to the affairs of the institution with which they are connected. When this is accomplished there will be few bank failures.

THE PERSONAL ELEMENT IN BANK SUPERVISION

An address delivered before the Fifteenth Annual Convention of the National Association of Supervisors of State Banks, held at Louisville, Ky., June 12-14, 1916, by Hon. F. W. Merrick, Commissioner of Banking, Michigan.

In an article of this length I will not attempt to discuss the subject, so far as it relates to the executive head of the department, other than to state it devolves upon him to procure the services of the best men possible, under the rather unfavorable conditions that obtain in several states as to salaries and number of examiners. It is an admitted fact that efficient bank supervision depends entirely on the character and ability of the examiners; and the successful operation of any supervising department depends primarily upon the men who report upon the internal conditions of the institution.

By this I do not mean to be understood that the balance of the supervising force can be of mediocre caliber, because the old adage still holds good that “a chain is no stronger than its weakest link”; but it is imperative that the system

*“The Modern Trust Company,” p. 21.

of bank supervision have for its base, men of intelligence, efficiency, character and experience constituting the examining force.

The reliability of the information furnished depends entirely on the clearness with which the examiner visualizes the internal circumstances and conditions of the bank. Any ordinary accountant can give a perfunctory recital as to what the books and accounts of the institution show on their face, but only the finished examiner is able to read between the lines and intelligently fathom the true inwardness of many transactions. The possession, or lack, of the necessary personal and mental qualifications mark the dividing line between mediocrity and efficiency. The personal element, therefore, is obviously necessary. We cannot hope to procure at all times men possessing all of these necessary qualifications, but we can and must obtain the services of those who possess the greater portion of such mental and temperamental attributes.

The question arises as to what comprises the qualifications, attributes or elements that are necessary in the make-up of a good examiner. Some of these we find inherent in men, while in others they are gained only by long terms of service and experience in a given line.

The crux of the whole matter is to get information—ascertain the facts.

The competent examiner must first be a judge of human nature. While the majority of bankers are more than willing to-day to impart all the information at their command, it is with the remainder that the examiner's knowledge of mankind must be exercised, and while he should give careful consideration to all information furnished by the bank officials, the same should be carefully analyzed, and his report to the head of the department should be based on his personal judgment of conditions.

There are various ways by which the tactful and resourceful examiner procures information. With some it comes only as a result of conversation and communication, both direct and indirect, from others, by argument, through sociability and affability; while in others it comes only by irritating and exciting the official, and sometimes by threats. The experienced and capable examiner intuitively knows what course to adopt in most cases. It is oftentimes necessary to resort to these tactics with the office assistants as well. While the examiner must ever be on the alert for indications of irregularities, and for unsafe methods, yet he must disguise any such suspicions. The examiner who enters an institution and betrays his suspicions of conditions works under a handicap, for precautions are taken to cover up and allay his suspicions and tighten up the avenues of information, especially if there is anything irregular in the conduct of the bank; while in the honestly conducted bank such a demeanor is openly resented. It devolves upon the examiner, therefore, to be tactful.

The efficient examiner follows the line of least resistance, so far as he can, but if results are not to his entire satisfaction, he, of course, has recourse to the more strenuous methods. The capable examiner, while courteous and affable, leaves no doubt as to his familiarity and knowledge of the business. He is careful, however, not to be officious, domineering, or indifferent to the opinion of others. If he decides it is for his best interest to be decidedly affable to all, he is careful not to leave the impression that he is doing it for a purpose, nor yet leave the impression that he is "easy" or gullible.

The examiner with a grouch works at a disadvantage. The grouchy or pompous examiner never invites the confidences of clerks, bookkeepers or employes, and many conditions have been discovered by chance or well intentioned

remarks of employes. Cheerfulness, therefore, is a valuable asset in the make-up of an examiner.

As in other pursuits, character is the greatest asset. Loyalty is an attribute of character and the conscientious examiner is ever conscious of his duty to all concerned; that is, loyalty to his department, and the best interests of the depositors, as well as stockholders, for it follows that disloyalty to the supervising department spells disloyalty to depositors and stockholders alike, who expect, and rightly so, that their interests are being at all times watched and safeguarded by their servant, the examiner.

The realization that he is a representative of the state or governmental department is ever present; and the opinion of the banker and bank employe, as well as that portion of the public with whom he comes in contact, is based upon the conduct, demeanor and ability displayed by the examiner in and about the discharge of his duties.

He should endeavor to come in contact with, and if possible secure the coöperation of the directors, and impress them with the idea that their interests are mutual.

The examiner should have a proper appreciation of order and system, possessing the necessary judgment to avoid being a slave to unnecessary methods. His experience, observation and judgment should fit him to suggest the departure from useless, cumbersome and ancient systems, as well as to recommend the installation of practical, up-to-date business ideas in handling the detail of the institution. He is careful to make these suggestions in such a manner as to not antagonize the bank official and his assistants, and in rare cases only insists on immediate change from one system to another.

As has been stated before, the chief aim of the examiner is to gain information bearing upon the internal conditions

of the bank, touching upon the safety of its loans or investments, the character, ability and worth of those who borrow the bank's funds, and as to the general, commercial or agricultural conditions in the district to which he is assigned. No fact is too trivial if it relates in any way to the habits, operations, or, in some cases, the physical condition of bank officials or bank creditors, for there are in this day and age, institutions and enterprises whose success or welfare depend on the health and life of some two or three men, and in some cases on that of one man.

The examiner must be a student of each and every condition that vitally affects the institutions in his district, and he must therefore be of a studious and analytical turn of mind, with the proper reasoning faculties to apply the information which comes to him as a result of his experience, observation and studies.

With the improvement in bank supervision in the last decade, the non-essentials of ten years ago are the important factors of present-day methods. Comments as to non-essentials, however, sometimes belittle criticism on vital matters; it is true that what may be termed "non-essential" in some banks may constitute serious infractions in others, and this presents another instance which calls for the exercise of good judgment on the part of the examiner.

The experienced bank inspector realizes that his sole duty is not along the line of discovering unsafe conditions. His analysis of conditions must be along the line of detecting the unsound tendencies, and to give the bank the value of his experience and observation in other institutions where a continuance of such conditions or practices leads to trouble or disaster.

It devolves upon the examiner to impress upon the bank and bank directors that the relationship to their bank is not of a general character, but that the department has a per-

sonal, individual interest in their respective banks, or in any situation which may concern them.

The supervising departments throughout the country have been brought more closely in touch with the active officers and directors of banks within the last few years, through the adoption of the plan of calling in as many directors as possible to assist the examiner or consult with him as to the assets and liabilities of a bank.

In Michigan there is much more coöperation between the directors of state banks and the department than ever before, and the breach that at one time existed is gradually lessening. Our examiners are to a large extent responsible for this in explaining and leaving the impression that the department's comments or criticisms are intended to be helpful rather than embarrassing, and are offered in the light of our experience and observation in connection with other institutions.

MEETING OF DIRECTORS IN CONNECTION WITH EXAMINATIONS

An address delivered before the Thirteenth Annual Convention of the National Association of Supervisors of State Banks, held at Atlantic City, N. J., July 6-8, 1914, by Hon. J. T. Mitchell, Bank Commissioner, Missouri.

Our Missouri examiners have been impressed with the importance of having, if possible, a full meeting of the Board of Directors at the close of each examination. At this meeting a detailed report of the condition of the bank is often given by the Examiner; not only are the weak spots in the bank pointed out, but attention is also called to the good features. As a consequence, the efficiency and deficiency of each department can then be determined by the Board. The fact that all acts of the officers will come before the Board has a salutary effect. This review of the business creates a livelier interest of the board in the busi-

ness of the bank. Too often they need this revival of interest—this periodical awakening.

(1) The board's attention may be called to any infraction of the law, or carelessness in observing its provisions. They may have been remiss in their duties and are glad to be set right. They are impressed with the trust imposed and the responsibility resting upon them as directors, where this is needed.

(2) This discussion need not be dictatorial—just a helpful statement of facts. This is not a school of instruction, but a fraternal talk between bankers.

(3) Often what seems a minor infraction of the law, becomes serious when the legality of some act growing out of that infraction is subject to an attack in court.

(1) A free discussion of conditions is beneficial to both the Board and the Department. Especially is this true in regard to valuing the loans and other assets held by the bank. Often the Examiner is able to get much information that is not shown by the books. Opinions that have been formed are strengthened by this meeting. The personnel of the directors and officers is considered. From the atmosphere of this meeting, he will form opinions affecting the bank, creditable or discreditable.

(2) They are also impressed with the fact that the banking business should be an exact business and that the system of clerical work should be such that errors, when made, may be detected.

(3) The busy banker is liable to overlook many of the decisions affecting his business and even some of the statutory requirements that are enacted for the safety of the banking business.

The directorate is an advisory board and the President, Cashier, or whoever may be the active manager, the daily and hourly guardian of the bank's business, is entitled to

the support and advice of a directorate that meets regularly and works earnestly. The quiet of the directors' room is the safety refuge from the rocks and shoals hidden in the current of daily business.

An institution manned by a good directorate, familiar with its workings—its weakness and its strength—lightens the labors of the Examiner in his periodical call and affords him at once a reliable source of knowledge—an easy access into the heart of things.

A well directed bank is like a smooth running piece of machinery—no friction, no jar, but an increased capacity for usefulness and good results.

A great percentage of the ills from which banks suffer and a great percentage of the labors of the Examiner and Supervisor may be traced directly to the dust upon the tables and chairs of the directors' room. These little particles of matter, light and impalpable as they seem floating, settling, covering the unused cobwebbed furniture, are the bane and blight of many an institution.

Stuffed clubs have been suggested; criminal statutes hinted at, as remedies for over 30-day-old accumulation of dust; but it settles in some places and a receiver settles the affairs of the bank thus cursed.

CHAPTER SEVEN

DIRECTORAL DUTIES, RESPONSIBILITIES AND LIABILITIES

THERE are divergent judicial opinions as to the degree of diligence a bank director must give to the affairs of his bank to fulfill his directoral responsibilities. Most of these opinions set out clearly that a director must give a sufficient amount of time, and use such diligence in this capacity, as a prudent man would use in the conduct of his own business.

Many cases have gone to the higher courts of the various states and of the United States, and almost universally the Courts' decisions have been that directors must be assiduous in this capacity.

DUTIES OF DIRECTORS

Judge Earle (82 N. Y., 65, 71)

"Few persons would be willing to deposit money in savings banks, or to take stock in corporations, with the understanding that the trustees or directors were bound only to exercise slight care, such as inattentive persons would give to their own business, in the management of the large and important interests committed to their hands. When one deposits money in a savings bank, or takes stock in a corporation, thus divesting himself of the immediate control of his property, he expects, and has the right to expect, that the trustees or directors, who are chosen to take his place in the management and control of his property, will

exercise ordinary care and prudence in the trusts committed to them . . . the same degree of care and prudence that men prompted by self-interest generally exercise in their own affairs. When one voluntarily takes the position of trustee or director of a corporation, good faith, exact justice, and public policy unite in requiring of him such a degree of care and prudence, and it is a gross breach of duty not to bestow them."

DUTY OF DIRECTORS TO EXERCISE SUPERVISION

Mr. Justice Harlan (*Briggs v. Spaulding*, 141 U. S., 168)

"We (Harlan, Gray, Brewer, Brown) are of the opinion that when the act of Congress declared that the affairs of a national banking association shall be 'managed' by its directors, and that the directors should take an oath to 'diligently and honestly administer' them, it was not intended that they should abdicate their functions and leave its management and the administration of its affairs entirely to executive officers. True, the bank may act by 'duly authorized officers or agents,' in respect to matters of current business and detail that may be properly intrusted to them by the directors. But, certainly, Congress never contemplated that the duty of directors to manage and administer the affairs of a national bank should be in abeyance altogether during any period that particular officers and agents of the association are authorized or permitted by the directors to have full control of its affairs. If the directors of a national bank choose to invest its officers or agents with such control, what the latter do may bind the bank as between it and those dealing with such officers and agents. But the duty remains, as between the directors and those who are interested in the bank, to exercise proper diligence and supervision in respect to what may be done by its officers and agents.

"As to the degree of diligence and the extent of supervision to be exercised by the directors, there can be no room for doubt under the authorities. It is such diligence and supervision as the situation and the nature of the business requires. Their duty is to watch over and guard the interests committed to them. In fidelity to their oaths, and to the obligations they assume, they must do all that reasonably prudent and careful men ought to do for the protection of the interests of others intrusted to their charge."

DUTY OF DIRECTORS TO EXERCISE GENERAL
SUPERVISION OF BANK

(*Society v. Underwood*, 9 Bush, 609)

"Bank Directors are not mere agents, like cashiers, tellers and clerks. They are trustees for the stockholders; and as to their dealing with the bank, they not only act for it and in its name, but, in a qualified sense, are the bank itself. It is the duty of the board to exercise a general supervision over the affairs of the bank, and to direct and control the action of its subordinate officers in all important transactions. The community has the right to assume that the directory does its duty, and to hold them personally responsible for neglecting it. (*Morse, Banks*, 76-77.) Their contract is not alone with the bank. They invite the public to deal with the corporation and when any one accepts their invitation he has the right to expect reasonable diligence and good faith at their hands; and if they fail in either, they violate a duty they owe, not only to the stockholders, but to the creditors and patrons of the corporation."

DIRECTORS MUST BE MORE THAN FIGUREHEADS

Chief Justice Fuller (141 U. S., 132)

"We hold that directors must exercise ordinary care and

prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figure-heads. They are entitled under the law to commit the banking business, as defined, to their duly authorized officers, but this does not absolve them from the duty of reasonable supervision, nor ought they be permitted to be shielded from liability because of want of knowledge of wrong-doing, if that ignorance is the result of gross inattention."

DIRECTORS CANNOT SHIRK DUTY AND AVOID LIABILITY

(A Tennessee Case)

"Directors, by assuming office, agree to give as much of their time and attention to the duties assumed as the proper care of the interests intrusted to them may require. If they are negligent, and losses result from acts committed by those left in control, the directors are responsible to the institution.

"It is the duty of a director to know his bank, and to see that its affairs are honestly and properly managed. He cannot shirk this duty and avoid liability."

DUTIES ASSUMED ON BECOMING A BANK DIRECTOR

(Mississippi Supreme Court)

"By accepting the position they (directors) assume capacity to manage the business; impliedly undertake to use diligence and care in performance of their duties; must give the enterprise the benefit of their best care and judgment; are bound to manage the bank as carefully as their own business; the fact that they serve without pay does not permit of a less degree of activity; must be diligent and careful in their duties, and imprudence and negligence cannot be excused on grounds of ignorance or inexperience,

or the honesty of intention; are not permitted to evade or delegate powers and important duties; supervision must be such as would enable them at all times to know the financial condition and to check imprudent and dishonest conduct."

DIRECTORS ARE RESPONSIBLE WHEN THEY ACCEPT POSITION AS SUCH

Mr. Justice Harlan (*Briggs v. Spaulding*, 141 U. S., 174)

"They (directors) ought not, by accepting and holding the position of directors, to give assurance to stockholders and depositors, whose interests have been committed to their control, that the bank is being safely and honestly managed, without doing what prudent men of business recognize as essential to make such an assurance of value. A banking corporation, publicly avowing that its business was to be wholly administered by executive officers, and that the directors would have nothing in fact to do with its management, would not long retain the confidence of stockholders and depositors, a fact which, of itself, shows that the abdication by directors of their duties and functions not only tends to defeat the object of the creation of such an institution, but puts in peril the interest of the stockholders and depositors."

MORE THAN "GOOD STANDING" REQUIRED OF DIRECTORS

(U. S. District Judge Severens)

"The idea is not to be tolerated that they (directors) serve merely as gilded ornaments of the institution to enhance its attractiveness, or that their reputations should be used as a lure to customers. The idea which seems to prevail in some quarters, that a director is chosen because he is a man of good standing and character and on that account will give reputation to the bank, and that his only

duty is to delegate to some other person the management of its affairs, and rest on that until his suspicion is aroused, which does not happen until the mischief is done, cannot be accepted as sound."

DIRECTORS MUST DISCHARGE THEIR DUTIES WITH CARE

Mr. Justice Earl (*Hun v. Cary*, 82 N. Y., 65)

"It seems to me that it would be a monstrous proposition to hold that trustees, intrusted with the management of the property, interests and business of other people, who divest themselves of the management and confide in them, are bound to give only slight care to the duties of their trust, and are liable only in case of gross inattention and negligence; and I have found no authority fully upholding such a proposition. It is true that authorities are found which hold the trustees are liable only for *crassa negligentia*, which, literally, means gross negligence; but that phrase has been defined to mean the absence of ordinary care and diligence adequate to the particular case. . . . Like a mandatary, to whom he has been likened, he is bound not only to exercise proper care and diligence, but ordinary skill and judgment. . . . These defendants voluntarily took the position of trustees of the bank. They invited depositors to confide to them their savings and to intrust the safekeeping and management of them to their skill and prudence. They undertook not only that they would discharge their duties with proper care, but that they would exercise the ordinary skill and judgment requisite for the discharge of their delicate trust."

DIRECTORS RESPONSIBLE FOR ACTS OF OFFICERS

Mr. Justice Harlan (*Briggs v. Spaulding*, 141 U. S., 169-170)

"If the directors of a national bank choose to invest its officers or agents with such control, what the latter do may

bind the bank, as between it and those dealing with such officers and agents. But the duty remains, as between the directors and those who are interested in the bank, to exercise proper diligence and supervision in respect to what may be done by its officers and agents. . . . Directors cannot in justice to those who deal with the bank, shut their eyes to what is going on around them. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision of its officers. They have something more to do than, from time to time, to elect the officers of the bank, and to make declarations of dividends. That which they ought, by proper diligence, to have known, as to the general course of business in the bank, they may be presumed to have known, in any contest between the corporation and those who are justified by the circumstances in dealing with its officers upon a basis of that course of business."

DIRECTORS CONTRACT FOR REASONABLE CAPACITY, SKILL AND CARE

Mississippi case (Wolfe v. Simmons)

"Directors of a bank are to be understood as contracting for reasonable capacity, skill, and care in the discharge of their duties, and are consequently liable for the want of such capacity, skill, and care, to all persons who have been damaged thereby."

DIRECTORS MUST KNOW HOW THEIR BANK IS BEING RUN

(Union National Bank v. Hill, 148 Missouri Supreme Court Reports)

"The board of directors of a bank are bound to know all that is done by it, as well as the system and rules arranged for its doing; and what they ought to know as to the

general course of the bank's business, they will be presumed to have known, in a contest between the bank and a third party dealing in good faith with it. The directors must use care and diligence to know the conduct of their subordinate officers, as well as to what the bank's books show, and to carefully observe the law under which the bank is organized. And the directors are answerable for losses sustained (by the bank) through the acts of its cashier in lending money in excess of prescribed limits and to insolvents, where the directors by care might have known—being therefore duty bound to know—that this was the case. It is no excuse for such neglect that the directors received no benefit from such loans and that their services are gratuitous."

DIRECTORS LIABLE FOR LACK OF SUPERVISION

(U. S. Sup., 1919)

"Directors of national banks under common-law obligation to exercise ordinary care and prudence.

"In addition to the specific duties defined in the national banking law, a director of a national bank is under common-law obligation to its depositors and shareholders as well as to borrowers, to exercise at least ordinary care and prudence in the supervision and administration of the bank's affairs.

"While knowledge may be essential to render a director liable as for a breach of duty specially imposed by the statute, this does not prevent application of the common-law rule in measuring violations of common-law duties. (250 U. S. 504) Justice Clarke said: 'That ordinary prudent and diligent men accepting election to membership on a bank directorate would not willingly absent themselves from directors' meetings for years, cannot be doubted; that a director who never makes or causes to be made any

examination whatever of the books and papers of the bank to determine its condition and the way in which it is being conducted, does not exercise ordinary care and prudence in the management of the affairs of the bank is equally clear, and . . . when guilty of neglect in both these respects, did not exercise the diligence which prudent men would usually exercise in ascertaining the condition of the business of the bank, or a reasonable control and supervision over its affairs and officers, is likewise beyond discussion. He cannot be shielded from liability because of want of knowledge of wrong-doing on his part, since that ignorance was the result of gross inattention in the discharge of his voluntarily assumed and sworn duty."

LIABILITY FOR LACK OF ATTENTION

"The fact that directors must commit details of business to executives and inferior officers does not absolve them from maintaining reasonable supervision. If such officers waste the bank's assets the directors cannot escape liability on the ground that they did not know of such waste, when it is made to appear that their ignorance was a result of a want of that care which ordinary prudent, diligent men exercise in business."

DIRECTORS' LIABILITY TO CREDITORS AND STOCKHOLDERS

(Seale v. Baker, 70 Tex., 292)

"If Bank Directors do not manage the affairs and business of the bank according to the directions of the charter and in good faith, they will be liable to make good all losses which their misconduct may inflict upon either stockholders or creditors or both."

LIABILITY FOR FAILURE TO CHARGE OFF
WORTHLESS ASSETS

(Chesborough v. Woodward, 195 Fed. Rep., 879)

"All Directors who participate in and approve a long continued carrying on the books of a bank among the loans and discounts of a line which they know is worthless and in amount sufficient materially to affect the standing of the bank, are bound to know that under the practice prevailing in such bank, such worthless paper will become an element of its published reports, and these reports will in so far falsely represent to the public the bank's condition; and so in a fair sense such Director permits the making of a report which is false; hence, his primary duty is to charge off assets which have become worthless."

LIABILITY OF INDIVIDUAL DIRECTOR FOR FAILURE TO
CHARGE OFF WORTHLESS ASSETS

(Chesborough v. Woodward, 175 Fed. Rep., 881)

"The duty to charge off worthless assets rests on the Board of Directors as an entity. But when this duty is wholly unperformed by the Board, an individual Director, who was engaged jointly in the performance of his functions, may nevertheless be individually liable because of his participation in the failure to charge off such worthless assets, whether or not such assets have entered into and become a part of the published statement of such bank."

LIABILITY FOR LACK OF ADMINISTRATION

(Chesborough v. Woodruff, 195 Fed., 875; 116 C. C. A., 465)

"Let it be conceded that the inattention of a director situated as was Bowerman has been brought about without any evil intention on his part, and that it may therefore work some hardship to hold him liable for the losses due directly to the positive negligence of the president and the

loan committee. But there is the other and wider view to be taken, that by which the law must always guard the interests of the institution and those of the public who were attracted to it . . . the interest of persons who have given their moneys to the custody of the bank, relying upon the belief that the directors, being men of integrity and business capacity, would at least make some effort to see that those in charge of the affairs of the institution would keep within the statutes and the by-laws which control. In the application of this wholesome doctrine one who fails to make any effort to have the bank properly administered acts wrongfully and becomes liable for non-action."

LIABILITY OF DIRECTORS TO STOCKHOLDERS

Judge Sharswood (71 Penn. St., 11, 20)

"It is by no means a well settled point what is the precise relation which directors sustain to stockholders. They are, undoubtedly, said in many authorities to be trustees, but that, as I apprehend, is only in a general sense, as we term an agent or any other bailee entrusted with the care and management of the property of another. It is certain that they are not technically trustees. They can only be regarded as mandataries—persons who have gratuitously undertaken to perform certain duties, and who are therefore bound to apply ordinary skill and diligence, but no more. . . . We are dealing now with their responsibilities to stockholders, not to outside parties—creditors and depositors—upon a close re-examination of all the reported cases, although there are many *dicta* not easily reconcilable, yet I have found no judgment or decree which has held directors to account, except when they have themselves been personally guilty of some fraud on the corporation, or have known and connived at some fraud on others, or

where such fraud might have been prevented had they given ordinary attention to their duties. I do not mean to say by any means, that their responsibility is limited to these cases, and that there might not exist such a case of negligence or of acts clearly *ultra vires*, as would make perfectly honest directors personally liable. But it is evident that gentlemen selected by stockholders from their own body ought not to be judged by the same strict standard as the agent or trustee of a private estate. Were such a rule applied, no gentlemen of character and responsibility would be found willing to accept such places."

DIRECTORS' LIABILITY TO DEPOSITORS

Summary of Court's Decision (John A. Delane et al. vs. Gardner Case, 121 Ill., 247)

"1. Bank directors—duty to depositors—liability for deposits made after insolvency. The directors of a bank are trustees for depositors as well as stockholders, and, as such, are bound to the observance of ordinary care and diligence to save depositors from loss, etc.

"2. If bank directors are guilty of negligence in permitting their bank to be held out to the public as solvent, when in fact it is insolvent, and thereby induce one to deposit his money with the bank, which he loses by reason of the insolvency of the bank, he may recover of such directors, in an action on the case, the damages he may thereby have sustained.

LIABILITY FOR GROSS NEGLIGENCE

Chancellor Walworth (Robinson v. Smith, 3 Paige, 222)

"The directors of a corporate who wilfully abuse their trust or misapply the funds of the company, by which a loss is sustained, are personally liable as trustees to make good that loss, and they are also liable if they suffer the

corporate funds to be lost or wasted by gross negligence and inattention to the duties of their trust."

LIABILITY TO DEPOSITORS

Speer v. Burlingame (61 Mo. App. Reports, 77)

"In an action by a depositor against the officers of a bank for receiving his deposits with knowledge of its insolvency, the plaintiff makes a *prima facie* case by evidence tending to establish the insolvency and summoning to his aid the presumption of law that defendants had knowledge of the insolvency and assented to the reception. Then, if the defendants testify to their ignorance of the insolvency and supplement it with evidence of corroborating facts and circumstances, the burden is seemingly shifted back to the plaintiff, and if he replies showing the opportunity of the defendants to know, coupled with other facts and circumstances, then it is the duty of the jury to weigh the evidence and decide according to its weight, and in the process the presumption of law loses all that it had of a mere arbitrary power; but if on the entire case the evidence was equally balanced, the presumption would preponderate the scale in favor of the plaintiff, and the jury should give the presumption whatever probative force they deem it entitled to."

LIABILITY TO DEPOSITORS

(Seale v. Baker, 70 Tex., 290)

"The Directors of a banking corporation are personally liable at the suit of the depositor for damages sustained by reason of the insolvent condition of the corporation where the depositor is induced to place his money in the bank solely by representation of solvency made to the general public by Directors who knew, or by ordinary care might have known, that such representations were false. If the

representations were untrue it is immaterial that they may have been made without fraudulent intent, and is sufficient if same were made to the general public if the depositor was induced thereby to deposit money in the bank."

LIABILITY FOR WRONGFUL PAYMENT OF DIVIDEND

(Cockrill v. Abeles, 86 Fed. Rep., 505)

"When directors place fictitious values on the assets in order to pay a dividend, such directors are liable."

LIABILITY FOR WILLFUL FAILURE TO ATTEND BOARD MEETINGS

(250 U. S., 504)

"A director of a National Bank who willfully fails to attend the meetings of the board of directors and otherwise to inform himself of the condition of the bank and to supervise its affairs is guilty of a breach of his common-law obligation, and liable for losses resulting from gross mismanagement by the executive officers which a proper attention to his duties might have avoided.

"The fact that a director resides at a distance from the location of the bank does not excuse him from responsibility."

DIRECTORS NOT LIABLE FOR BAD JUDGMENT

(250 U. S., 504)

"Bad judgment on the part of directors as to the condition of the assets, without bad faith, does not make them individually liable."

DIRECTORS REQUIRED TO ACT IN GOOD FAITH

(Stone v. Rottman, 183 Mo., 552)

"A director of a bank is only required to act in good faith and to exercise such a degree of care as a reasonable,

prudent man would exercise under the same circumstances. He is not bound to exercise the same degree of care which a prudent man would exercise in his own business. This is too high a standard. To expect a director, under such circumstances, to give the affairs of the bank the same care that he takes of his own business, is unreasonable, and few responsible men would be willing to serve under such terms. In the case of a city bank doing a large business, he would be obliged to abandon his own affairs entirely. A business man generally understands the details of his own business, but a bank director cannot grasp the details of a large bank without devoting all of his time to it, to the utter neglect of his own affairs."

CHAPTER EIGHT

THE DIRECTORS' AUDIT

"DIRECTORS cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision of its officers. They have something more to do than, from time to time, to elect the officers of the bank, and to make declarations of the dividends. That which they ought, by proper diligence, to have known as to the general course of business in the bank, they may be presumed to have known in any contest between the corporation and those who are justified by the circumstances in dealing with its officers upon the basis of that course of business." (Martin v. Challen, 110 U. S. 7, 15.)

The foregoing is one instance where the Supreme Court of the United States has set out that it is the duty of the directors to acquaint themselves with the condition of their bank. The Federal Courts and most State Courts have, in many instances, defined the duties of bank directors and set out their liabilities for lack of management.

The Comptroller of the Currency and the Banking Departments of practically every State require committees of directors or stockholders to make an audit of their banks once or oftener each year. A study of the requirements of the various states, and the forms used, vary so widely that no comparison can be made, the forms varying from mere affidavits to the most exhaustive reports.

It is true that the average bank director knows little, if anything, about bank auditing, and, therefore, in far too

many instances, the audits are perfunctory, some active officer of the bank doing the actual work and the committee "signing on the dotted line." If these audits are actually made they give the committee, and therefore the entire board, an excellent insight into the affairs of their banks, for in making the audit the committee actually sees just how a bank's business is being handled by the active officers, and how its affairs are being conducted.

"Directors of a bank are bound to use diligence in acquiring knowledge of its business; they cannot be heard, when sued, to say that they were not apprized of facts the existence of which is shown by the books, accounts and correspondence of the bank." (19 Kas., 60.)

It is the purpose of this chapter to outline the procedure for an auditing committee, that its work may be thoroughly completed in the shortest possible time. There are many matters pertaining to auditing that it is not necessary nor practical to discuss, but if the procedure outlined in this chapter is followed a complete check of the bank's books and business will be accomplished.

*"The members of this (auditing) committee should consist of men who are adapted to this class of work. They are required to actually examine the assets and liabilities and prepare their report from actual knowledge and not upon representations made by the president, cashier, or any managing officer of the bank.

"Every director should fully realize the responsibility of this examination and the liability which he assumes in certifying to reports. Directors should refuse to approve or certify the report of any examining committee which has been prepared by the cashier, unless he is a member of such committee of the board of directors which actually made the examination.

"These reports are intended to present the condition of a

*"Rules and Regulations," Banking Department of Oregon.

bank as a result of careful examination and not merely as a report prepared by the president or cashier, and signed by the committee or board of directors as a matter of form."

WHEN TO BEGIN THE AUDIT

If a thorough audit of a bank is to be made, the examination or audit should begin at the close of the day's business and after all of the day's postings are complete. No announcement should be made of the intended audit, the auditing committee being the only ones having knowledge of the date set for the audit.

The committee should, immediately upon entering the bank, take charge of all of the bank's assets, including cash, notes, and other securities, as well as all of the bank's records. As a practical matter, the committee will probably find it cannot carry out this suggestion in its entirety, but it should be carried out as nearly as is practicable. The audit will consume considerable time, and it will be necessary for the officers to have the bank's records, and probably some of its securities, before the committee has verified them.

The committee should, upon entering the bank, have the general bookkeeper prepare a statement showing the bank's condition at the close of business on the day the audit is to begin. This statement should be checked back against the general ledger to see that it is correct.

The procedure in the verification of the various assets and liabilities varies, and it is difficult to say just what assets or liabilities should be checked first. However, in order that the business of the bank may not be unduly interfered with, those assets and liabilities should be checked first which are likely to change first and most frequently. For this reason it is customary to count the cash first.

BANK DIRECTORS

COUNTING THE CASH

If practical, all cash should be counted. This includes currency, gold, silver, and minor coin. If large amounts of cash are on hand it may not be practicable to count the cash piece by piece, but it is especially desirable to count all the currency. The silver, gold and minor coins, if stored in bags, can be checked by weight. Several sacks of the coins taken at random, however, should be counted and all of the bags should be opened and inspected to see that they actually contain the kind of moneys indicated.

The following table of weight and values will be found useful in weighing gold and silver coins:

GOLD COIN		
<i>AMOUNT</i> (dollars)	<i>WEIGHT (avoirdupois)</i>	
	<i>Pounds</i>	<i>Ounces</i>
100	0	5.897
200	0	11.794
300	1	1.691
500	1	13.486
1000	3	10.791
2000	7	5.943
3000	11	.914
4000	14	11.886
5000	18	6.857

SILVER DOLLARS		
100	5	14.28
200	11	12.57
500	29	7.43
1000	58	14.83

FRACTIONAL SILVER		
100	5	8.18
200	11	.36
500	27	8.91
1000	55	1.83

An accurate and easy method of counting coins is to take a stated number of coins, say ten or twenty, carefully

counted, stack them on an even surface and place along side of this similar piles of the same kind of coins.

Where nickels and other minor coins are found in large quantities, the contents of the packages may be examined and their value determined by careful estimate of the bulk without making an actual count of the number of pieces contained in each package.

After the cash has been counted the amount should be checked against the general ledger to see that the actual cash on hand agrees with the amount shown by the books of the bank.

Often banks carry as cash, "cash items," items on which cash has been paid out, but for some reason the items have not been charged to the accounts against which they are drawn. The cash items should be carefully examined by the committee. It is sometimes found that the officers of the bank are carrying as cash items various checks, notes, or other items which are irregular. The committee should see that no "stale or irregular" items are being carried. A list of all uncurrent or irregular items, those that will not be cleared out in the following day's business, should be prepared and a satisfactory explanation should be had concerning each such item.

Listed and carried as cash may be found "Exchanges for Clearing House," "Checks on other banks in the same city or town," and "Checks and drafts on banks located outside of the city or town." These items should be separated from and not confused with "cash items," for they are current items which will be cleared in the course of business on the following day. These items should be listed and compared with the totals shown on the "Cash Book," to see that they are carried for the correct amounts.

Every bank should have a "Teller's Cash Book," which should be posted in ink at the close of business each day,

after the cash has been balanced. The foregoing items are usually carried to "cash" on the general books from the total shown by the Teller's Cash Book, and the amount so shown by that book should be checked against the general ledger or daily statement to see that it is carried correctly.

There are several forms of Teller's Cash Books. The form shown on page 119 is good.

Be sure to inspect the Teller's Cash Book to see that it is kept in ink and if not let one of your recommendations be that the board of directors require it to be posted each day in ink.

As soon as the cash is counted it should be released to the officers of the bank, together with all items carried as cash which are regular, so that they may be available at the beginning business on the following day.

PROVING THE DEPOSIT LEDGERS

In order of importance, that the bank's regular business may not be interfered with, the individual ledgers should next be proved. As stated in the beginning, if a thorough audit is desired it is important that the bank's books be taken charge of by the committee. This applies particularly to the individual and other deposit ledgers, for it has been found that if there are defalcations of any appreciable amount, they are, usually, covered up in the ledgers, at least a large part of the shortage often is.

It is desirable for the committee to make an adding machine list of the deposit ledgers. If overdrafts are found, the name of the party overdrawn, and the amount of the overdraft should be taken down on a sheet of paper. After the ledgers are "pulled" the overdrafts listed can be totaled. The total of the deposits and also of the overdrafts should be compared with the general ledger to see that they agree. The committee should inspect each overdrawn account to

TELLER'S CASH BOOK

DATE _____ 19 _____

DESCRIPTION	AMOUNT	TOTAL
VAULT ITEMS		
GOLD		
CURRENCY		
SILVER \$1.00		
SILVER 50c		
SILVER 25c		
SILVER 10c		
NICKELS		
PENNIES		
TOTAL		
--		
TRAY ITEMS		
GOLD		
CURRENCY		
SILVER \$1 00		
SILVER 50c		
SILVER 25c		
SILVER 10c		
NICKELS		
PENNIES		
MUTILATED COIN		
MUTILATED CURRENCY		
DRAFTS		
NET CASH		
CASH ITEMS		
CASH OVER		
CASH SHORT		
JOURNAL BALANCE		

FORM NO. 1

inform itself how the officers of the bank handle such accounts. Particular attention should be given to see whether the same customers are habitually overdrawn.

It may be that there are a number of ledgers, and the members of the committee may be inexperienced in operating adding machines. In that event it would be permissible for the committee to have some employee of the bank who has nothing to do with the keeping of the ledgers, make the adding machine lists. In this event the lists should be "called back," one member of the committee calling the amounts from the ledgers and another member checking the amount shown on the adding machine list. If this method of proving the ledgers is used, the member of the committee who calls from the ledger should watch for overdrafts and make the list as indicated in the foregoing paragraph. The totals as shown by the adding machine lists should be checked against the general ledger to see that the deposits are correctly shown.

LOANS AND DISCOUNTS

There is no more important item in the whole bank than loans and discounts. As has already been stated, they comprise a large part of the bank's total assets and therefore the bank's solvency depends to a great extent on the worth of its loans and discounts.

The loans should be proved by making an adding machine list of the notes, checking the total as shown by the list against the general ledger to see that they agree. If the loans are properly kept, credits properly given, and balances due extended, there will be no difficulty in balancing the notes in this manner. If they are not kept so that they can be balanced in this manner they are not being properly kept and the committee should require the officers of the bank to keep them properly.

If the officers keep the notes filed properly, all credits entered on the notes and balances due extended, copies of notes hypothecated (such copies should plainly show they are copies and also where they are hypothecated) there should be no trouble in making a correct list of the notes. If you have trouble in getting the notes to balance it is probably the fault of the officer having the notes in charge, for each note should speak for itself, so that any one may inspect the notes and, by taking a total as shown by all the notes, arrive at the correct amount of loans and discounts on hand.

Rubber stamps can be obtained which will clearly show both interest and principal payments, balances due, and extensions by interest payments.

ENDORSEMENT ON PRINCIPAL		BALANCE DUE ON PRINCIPAL
.....19	\$.....	\$.....
.....19	\$.....	\$.....
.....19	\$.....	\$.....
.....19	\$.....	\$.....

ENDORSEMENT ON INTEREST

.....19	\$.....	to	19
.....19	\$.....	to	19
.....19	\$.....	to	19

Payments on principal, interest payments, extensions and renewals are very important. Payments of both principal and interest should be entered on the note in ink. Many banks are using a note which shows, on its face, interest and principal credits, similar to the form shown on page 122.

Probably the most valuable part of the entire audit is the benefit the bank will receive from a proper check of the loans and discounts by the committee, and its report

Cattle _____ Horses _____ Mares _____ Mules _____ Hogs _____ A. Corn _____ A. Cotton _____ Vehicles _____ A. Land _____		Meno, Ark. _____ 192____ _____ after date for value received, I, we or either of us promise to pay to the order of _____ _____ DOLLARS With interest at the rate of _____ per cent per annum, payable annually from _____ until paid, payable as with collection charges and attorney's fees, if not paid when due. The maker and en- dorsers of this note hereby severally waive appointment for payment, notice of non-pay- ment and protest, and consent that the time of payment may be extended without notice thereof with right to call for additional security at any time if for any reason said _____ deems this note insecure with full authority to add or assign, to all the same at public or private sale without notice of non-payment of this note, since the default in the payment of ac- cused interest when due, all principal and interest then remaining unpaid shall be due and payable immediately.	Principal, \$ _____ Interest, \$ _____ Total, \$ _____ <table border="1"> <thead> <tr> <th>DATE</th> <th>PAID</th> <th>BALANCE</th> </tr> </thead> <tbody> <tr> <td>1921</td> <td></td> <td></td> </tr> <tr> <td>1922</td> <td></td> <td></td> </tr> <tr> <td>1923</td> <td></td> <td></td> </tr> <tr> <td>1924</td> <td></td> <td></td> </tr> <tr> <td>1925</td> <td></td> <td></td> </tr> <tr> <td>1926</td> <td></td> <td></td> </tr> <tr> <td>1927</td> <td></td> <td></td> </tr> <tr> <td>1928</td> <td></td> <td></td> </tr> <tr> <td>1929</td> <td></td> <td></td> </tr> <tr> <td>1930</td> <td></td> <td></td> </tr> </tbody> </table>	DATE	PAID	BALANCE	1921			1922			1923			1924			1925			1926			1927			1928			1929			1930		
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Renewal of No. _____ dated _____ 192____		NO _____ ENDORSEMENT _____ EX. _____ DU. _____	NOTICE _____																																	

FORM No. 2

and recommendations to the board of directors based on its findings.

After the loans have been proved an appraisal of them should be made by the committee. Each line of credit should be carefully reviewed. Every bank, no matter how small, should have a Liability Ledger, which should be kept posted up at all times. Many banks have Liability Ledgers which are not complete. Others have Liability Ledgers but never keep them posted up to date. A good form is shown here, and should show the liability as both maker and endorser. If your bank has an adequate Liability Ledger it will be of much assistance to you at this point of your audit, and if none is kept the committee should proceed to build up one as the notes are reviewed, and require that thereafter it be kept posted up at all times.

FORM LL-2		SHEET NO. 1		LIABILITY LEDGER											
CREDIT LIMIT \$ 5000.00				NAME <i>John H. Henderson & Company</i> ADDRESS <i>708 So. 2nd St.</i>											
DATE	REMARKS	DATE DUE	DATE PAID	AMOUNT	BY ENDORSER	BY MAKER	DATE	AMOUNT	DATE	AMOUNT	DATE	AMOUNT	DATE	AMOUNT	
1921	1000.00	1922	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	
1922	1000.00	1923	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	
1923	1000.00	1924	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	
1924	1000.00	1925	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	
1925	1000.00	1926	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	
1926	1000.00	1927	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	
1927	1000.00	1928	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	
1928	1000.00	1929	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	
1929	1000.00	1930	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	1000.00	

FORM No. 3—LIABILITY LEDGER

In reviewing the lines of credit a form similar to the one given on page 124 may be used, which will give much valuable information when the audit is complete.

A complete liability ledger is one of the best credit records a bank can have, and of so much value that a bank can ill afford to be without one. If your bank has no liability ledger, or one that is inadequate, let one of your recommendations be that one be obtained immediately, and that it be properly kept at all times.

In reviewing the loans the following things should be kept in mind by the committee:

1. Credit standing of the maker.
2. Credit standing of endorsers.
3. Worth of collateral or security.
4. Is collateral properly assigned?
5. If secured by real estate is security adequate?
6. Are mortgages properly drawn and are they recorded?
7. If secured by chattels is security ample and are mortgages recorded?
8. If secured by real estate, are buildings insured, and do insurance policies have "Loss payable to bank clause."
9. Are loans desirable, slow, doubtful or bad?

The committee should carefully review all past due paper and ascertain from an officer why it remains past due. Extreme care should be used in the examination of notes extended by interest endorsement. It has been found in some instances that notes have been extended by officers from time to time, such extensions never having come before the board of directors.

It is bad practice to extend personal and collateral notes by interest endorsements. New notes should always be taken. There are many legal complications which might arise out of extensions, especially if there are endorsers on

NAME	GOOD BUT SLOW	COLLECTIBLE BUT UNDESIRABLE	DOUBTFUL	BAD	REMARKS AND RECOMMENDATIONS

Form No. 4—Form to Use in Appraising Loans and Discounts

the notes. It is sometimes not practical or desirable to make new notes on real estate or chattel loans, and when extensions on these classes of loans, as well as on personal and collateral, are granted upon interest payments, the date to which the note is extended should be clearly shown by endorsement on the note, as explained heretofore.

The importance of financial statements cannot be overestimated. Their importance is too often minimized. Too often loans are made without definite knowledge concerning the financial responsibility of the borrower, when a financial statement, if required, would reveal that the borrower is not entitled to a loan as large as he has requested, and sometimes none at all.

Sometimes the officers of a bank think they are acquainted with the financial condition of their customers and that the customer is doing all of his borrowing from their bank. Later, and usually when it is too late to do any good, the banker finds that his customer is also borrowing from other banks.

An actual case is recited: The cashier of a bank in a small city, which bank had a number of country bank accounts, was well regarded and considered good by most people who knew him. He became interested in several outside enterprises, and it required more money than this bank could loan him. This cashier owned stock in several country banks and to these he went to borrow the additional funds needed. The officers and directors of these banks considered him GOOD and readily granted him the loans. Finally the crash came. The enterprises into which he had gone were not successful. He resigned the cashiership of the bank and in a few months was bankrupt. The small banks which had loaned him money had all done so upon his open note, without a financial statement, and practically every dollar was a loss.

This is but one example. There are many similar cases. Be careful of the prospective borrower who does not do his banking business with you, but who comes to your bank to borrow. Usually he has exhausted his credit with his bank, and it behooves you to use more than ordinary care in such cases. His promise that he intends to do business with you in the future may be in good faith, but there should be other more valid reasons before credit is extended to such parties.

There are many excellent forms of financial statements. Given hereafter are the forms used by the Federal Reserve Bank of St. Louis, which forms are furnished free to member banks of the Eighth Federal Reserve District. (See Forms 6, 6A, 7, 7A, 8, 8A, 9, 9A, pages 128, 129, 130, 131, 132, 133, 134.)

BONDS AND SECURITIES

All bonds and securities belonging to the bank should be carefully checked. If large amounts of warrants are owned, they should be separated into the various classes to which they belong and adding machine lists made of each class. To verify bonds and securities, and in order that the committee may be advised as to whether or not they are being carried at their actual value, or more or less, the form shown on page 127 may be used.

The totals at which these securities are carried on the books should be checked against the general ledger to see that they agree.

CERTIFICATES OF DEPOSIT

The committee will find that the bank examiner usually checks off of the certificate register all certificates which have been paid. The certificates which have been paid and cancelled since the last examination by the bank examiner, should be called for and checked off of the register

BONDS AND SECURITIES

BOND OR SECURITY	FACE VALUE	CARRIED AT	MARKET VALUE

STOCKS

STOCK	PAR VALUE	CARRIED AT	MARKET VALUE

FINANCIAL STATEMENT—MERCHANTS

BANK

TO THE

of

Corporation
Partnership

Name

Branches

Business

(Describe kind of business fully and state whether wholesale or retail)

For the purpose of procuring credit from time to time, the undersigned hereby makes to you the following statement of the condition of the undersigned on the _____ day _____ 19____, and the undersigned hereby maintains and guarantees that said statement is in all respects true and correct, and you may consider said statement as to the pecuniary responsibility of the undersigned as continuing to be true and correct until written notice of a change is given to you by the undersigned.

ASSETS				LIABILITIES			
CASH on hand				TRADE ACCEPTANCE			
CASH in _____ Bank				BILLS PAYABLE Given for merchandise			
LIBERTY BONDS				BILLS PAYABLE negotiated to own hands			
TRADE ACCEPTANCES				BILLS PAYABLE otherwise disposed of			
NOTES RECEIVABLE of customers (not transferred or pledged)				BILLS PAYABLE to directors or stockholders			
ACCOUNTS RECEIVABLE of customers (not transferred or pledged)				ACCOUNTS PAYABLE			
NOTES and ACCOUNTS RECEIVABLE of partners, officers or stockholders (full status listed or indicated)				DEPOSITS OF MONEY WITH US			
MERCHANDISE finished (how valued _____)				MORTGAGE ON REAL ESTATE			
" unfinished (how valued _____)				CHattel MORTGAGE DEBT			
INVESTMENTS stocks and bonds (list in full above, per _____, market value and names)				OTHER LIABILITIES			
REAL ESTATE used in business				TOTAL LIABILITIES			
FIXTURES used in business				NET WORTH			
OTHER ASSETS				TOTAL			
TOTAL				*CAPITAL STOCK \$			
				SURPLUS & PROFITS \$			
				(*Full out above 2 lines of Corporation)			
				TOTAL			

Dr. PROFIT AND LOSS ACCOUNT, FISCAL YEAR ENDING _____ 19____ Cr.

Actual expense of conducting business	\$		GROSS PROFITS		
Bad Debts charged off	\$		From Merchandise	\$	
Withdrawals or Dividends Paid	\$		From Investments	\$	
Net Profits	\$		From Other Sources	\$	
TOTAL	\$		TOTAL	\$	
Trade Acceptances Notes or Accounts Receivable discounted or sold	\$		Date of last annual statements preceding above statement		
Accommodation endorsements	\$		Net worth shown by that statement	\$	
Insurance on Buildings	\$		Merchandise on hand on that date	\$	
Insurance on Merchandise	\$		Amount of merchandise bought since that date to date of above statement	\$	
			Total sales of merchandise in the same period	\$	

On what assets are mortgages a lien?

Is statement based on actual inventory?

If so, give date of inventory

What amount of merchandise has been on hand over one year?

What amount of accounts and bills receivable are past due and extended? \$

Usual terms on which you buy?

Usual terms on which you sell?

Total sales for past twelve months \$

CREDIT STATEMENT—AGRICULTURAL.To the _____ of _____
(Name of Bank) (Location)

For the purpose of procuring credit from time to time with you for my negotiable paper or otherwise, I furnish the following as a true and accurate statement of my financial condition on _____ which may hereafter be considered as representing a true statement of my financial condition, unless notice of change is given you

PROPERTY OWNED BY UNDERSIGNED	DEBTS DUE BY UNDERSIGNED
CASH in bank and on hand	ACCOUNTS PAYABLE by me
GOOD ACCOUNTS due me of Tenants for Current Crop	NOTES PAYABLE by me
of Tenants for Past Crops	NOTES due by me secured by chattel mortgage
Other Accounts	MORTGAGE on land
GOOD NOTES or hand Unsecured	All other debts
Secured	
LIVE STOCK on hand, Horses and Mules	
Cattle	
Hogs	
FARM PRODUCTS on hand grain, cotton, hay, feed, etc. (Specify Products and Amounts)	
FARM LANDS _____ acres	
OTHER LANDS _____ acres	
BUILDINGS on farm are worth	
CITY REAL ESTATE, if any (Describe and give value of any other property)	
	I have endorsed or guaranteed notes for others amounting to \$ _____
TOTAL PROPERTY.	TOTAL DEBTS

QUESTIONS TO BE ANSWERED REGARDING FARM LAND

Farm is situated in County of _____ State of _____

Described as follows: Range, Section, Township, Etc _____

Total number of acres? _____ Acres under cultivation? _____ Acres unfit for cultivation? _____

Any reasonable year, this land will produce per acre: _____ bales cotton; bushels of wheat _____; bushels of corn _____

Other crops _____

(OVER)

Is land subject to overflow? _____ How long have you owned this land? _____

Is any part rented, how much, and for what rent? _____

Distance from nearest town to your farm? _____ miles from _____

Distance from nearest railroad station to farm? _____ miles from _____

At what price per acre have improved farms in your neighborhood sold during the past year? _____

At what price per acre has rough land in your neighborhood sold in past year? _____

Is there any mortgage on your land? Amount _____ due _____

Is the title to the land in your name? _____

For what is this land assessed for taxation? _____

I hereby solemnly declare and certify that the above is a true statement of my financial condition.

(Signed) _____

Date _____

Address _____

FINANCIAL STATEMENT—STOCKMEN

To the _____ of _____
 (Name of Bank) (Location)

For the purpose of procuring credit from time to time, the undersigned hereby makes to you the following statement of the condition of the undersigned on the _____ day of _____, 19____; and the undersigned hereby maintains and guarantees that said statement is in all respects true and correct, and you may consider said statement as to the pecuniary responsibility of the undersigned as continuing to be true and correct until written notice of a change is given to you by the undersigned.

(Fill all blanks writing "no" or "none" where necessary to complete information.)

PROPERTY OWNED BY UNDERSIGNED		DEBTS DUE BY UNDERSIGNED	
Personal Property.		Encumbrance on live stock, as follows.	
Number _____		To _____	\$ _____
Steers 1's @ \$ _____ per head	\$ _____	Dated _____ 19____ Due _____	
Steers 2's @ \$ _____ per head	\$ _____	Covering _____	
Steers 3's @ \$ _____ per head	\$ _____	To _____	
Steers 4's up @ \$ _____ per head	\$ _____	Dated _____ 19____ Due _____	
Heifers 1's and 2's @ \$ _____ per head	\$ _____	Covering _____	
Cows @ \$ _____ per head	\$ _____	To _____	
Calves (19____) @ \$ _____ per head	\$ _____	Dated _____ 19____ Due _____	
Bulls @ \$ _____ per head	\$ _____	Covering _____	
Horses @ \$ _____ per head	\$ _____	To _____	
Mules @ \$ _____ per head	\$ _____	Dated _____ 19____ Due _____	
Sheep @ \$ _____ per head	\$ _____	Covering _____	
Hogs @ \$ _____ per head	\$ _____		
Feed on Hand as follows (Itemize)		Notes to banks—unsecured	
Cash in _____ Bank	\$ _____	All other debts	
Liberty Bonds	\$ _____	Mortgage or lien on land	
Accounts due me	\$ _____		
Notes due me	\$ _____		
Machinery and Tools	\$ _____		
All other personal property	\$ _____		
Farm land, acres	\$ _____		
Buildings	\$ _____		
Other Lands	\$ _____		
Other Real Estate	\$ _____		
TOTAL PROPERTY	\$ _____	TOTAL DEBTS	\$ _____

Amount of insurance on feed, \$ _____; on machinery, \$ _____; on stock, \$ _____; on buildings, \$ _____; Life, \$ _____

The title to the above property—real and personal—is in name of _____

(OVER)

I have under lease from _____ acres of _____ land
in _____ the rental price being \$ _____ which has been paid to, _____
19. Lease expires, _____ 19 _____

Are there any judgments or suits pending against you at this time? _____

I have resided at above location _____ years _____ month. Formerly resided _____

I have endorsed or guaranteed notes or accounts for others amounting to \$ _____

Under the laws of this State I or my heirs are entitled to legal exemption of _____ acres included in this statement,
worth \$ _____ and \$ _____ for improvements and \$ _____ for tools and supplies. There
is no other property included in this statement which is subject to exemption.

I hereby certify that, to the best of my knowledge and belief, the figures and information given are, in every respect, true and in accordance with the facts.

(Signed) _____

FORM No. 9-A—STOCKMEN'S FINANCIAL STATEMENT

with some mark not similar to that of the bank examiner. In checking off the paid certificates the amount for which certificates were issued should be compared with the amount shown on the register. An adding machine list of the unpaid certificates, those certificates which have not been checked off of the register, should be made and the total compared with the amount as shown by the general ledger.

As certificates are paid by the bank they should be arranged numerically and filed. If any certificates are

FORM
CD

RECORD OF CERTIFICATE OF DEPOSIT ISSUED

DATE ISSUED	TO WHOM ISSUED	DEPOSITED BY	NO.	AMOUNT	DAILY TOTALS	TIME	RATE	INTEREST	DATE PAID
10/21									
	ENDORSEMENT								
9/12	Joe A. Ewing		2	100.	100.00	6	5%		
	Mrs. Bertha Ewing		101	250.	250.00	12	5%		
	E. B. Matheson		102	100.	100.00	12	5%		

FORM No. 10—CERTIFICATE OF DEPOSIT REGISTER

BANK DIRECTORS

voided they should not be destroyed, but should be filed in their regular order so that they may also be checked off of the register.

CASHIER'S CHECKS

The same procedure for the verification of Cashier's Checks may be used as is described for the verification of certificates of deposit.

FORM CA		RECORD OF CASHIER'S CHECKS ISSUED							
DATE 11/2	PAYABLE TO ORDER OF	BY WHOM PURCHASED	NO	AMOUNT	DAILY TOTALS	DATE PAID			
9/12	Frank H. Smith	E. A. Cox	357	100.00					
	Brown, Adams & Co.	J. C. Burme	81	25.00					
	The Miller Mfg. Co.	A. W. Barker	82	25.00					

FORM No. 11—CASHIER'S CHECK REGISTER

CERTIFIED CHECKS

When checks are certified they should be registered in a book for that purpose, form of which is given below. When they are paid they should be retained by the bank, and not returned to the drawer of the check except upon proper receipt, which receipt should be filed and carefully preserved. The same procedure for the verification of outstanding certified checks may be followed as described for the verification of certificates of deposit.

FORM CC		RECORD OF CHECKS CERTIFIED							
DATE 11/2	DRAWN BY	PAYABLE TO	NO	AMOUNT	DAILY TOTALS	DATE PAID			
11/2	W. C. Smithers	Robt R. Jones	10	100.00				11/2	
	J. P. Jones	Geo. J. McGraw	01	100.00					
	Arthur W. Martin	Wm. L. Abbecker	02	25.00					

FORM No. 12—CERTIFIED CHECK REGISTER

BANKING HOUSE, OTHER REAL ESTATE, FURNITURE
AND FIXTURES

The committee should call for deeds to the banking house and other real estate. These deeds should be carefully in-

spected to see that title is in the bank and that deeds have been properly recorded. It should satisfy itself that "other real estate" has not been carried longer than is permitted by law.

Insurance policies should be called for to ascertain that sufficient insurance is being carried on the banking house and furniture and fixtures, and to see that the insurance is in force.

The committee should acquaint itself with the values of the various parcels of real estate owned, and also as to the value of the banking house and furniture and fixtures, so that it may make recommendations as to needed improvements or as to depreciations, which should be made in amounts at which these items are being carried. It should see that the vault and filing systems are adequate for the filing and preservation of records and that they are being kept in proper order.

BALANCE DUE FROM BANKS AND BANKERS

The verification of the amounts due from other banks is important. The committee should call for the last statements rendered by corresponding banks. The reconciliation of these accounts as made by the officers of the bank should be carefully checked, and if there are any irregular items, an explanation should be required of the proper officer. If the reconciliation shows any items charged by the bank under examination, which had not been credited at the date statement was rendered, the officers of the bank should be requested to show the committee credit advices from the corresponding banks.

It is altogether proper for the committee to request corresponding banks to furnish statements as of the date of examination, with debits and credits for two or three days subsequent to date of examination. Upon receipt of these

statements the committee can reconcile the accounts with corresponding banks.

If the bank under examination has not a "reconciliation book," with accounts of all corresponding banks properly kept therein, the committee should recommend the immediate purchase of such book, form of which is here given.

[illegible]

FORM No. 13—RECONCILEMENT BOOK

Bank examiners in making examinations use forms requesting corresponding banks to furnish certain information. The information requested and the forms used are of sufficient importance to be here given. They are used to verify "balances due from" and "balances due to" corresponding banks.

Below is list of bills receivable of the bank under examination held by you as collateral to their notes due you. Please certify to the correctness of this list over the signature of an officer of your bank.

STATE OF ARKANSAS

Banking Department

CITY OF LITTLE ROCK

To the Cashier

Sir. This circular is sent under instructions from the Bank Commissioner for the purpose of reconciling the account of the within named bank with that of your bank at date of examination.

You are respectfully requested to furnish fully the information asked for on the other pages of this circular and to forward same at your earliest convenience

to

from whom this is received.

An addressed envelope for your reply is enclosed herewith

Respectfully yours,

Bank Commissioner

FORM NO. 14—USED TO VERIFY "BALANCES DUE FROM" BANKS

Answers to the following questions are respectfully requested:

The bodies of the _____

at the close of business on _____ due
showed a balance of \$ _____
the _____

Please send copy of Statement (Daily Transcript Sheets) of the above named bank from _____ to and including _____ (Do not send cancelled vouchers)

Enter below credits for three days after date of our examination.

[illegible]

2. Has your bank now under discount any bills receivable of the bank named, or any on which its official indorsement appears, or for which it is in any other way liable? If so, please furnish a list, giving names and amounts.

2. Does your bank now hold bills receivable or any securities belonging to the bank named, or any on which its official indorsement appears, for or for which it is in any other way liable? If any are held, give list and state how they are held.

- 3 Are there any loans now outstanding by your bank to the bank named, or to any other party for which the bank is in any way liable? If so, specify character of loan—whether upon bills payable, certificate of deposit, open account or otherwise. In each case specify amount, time, etc.

- 4 Has your bank effected any loans for account of the bank named? If so, give names of borrowers and amounts, state how the notes are secured and whether or not the security is held by your bank

1

- 5 Please state when your account with the bank named was last reconciled

6.

Received _____, 19__

Cashier.

Answers to the following questions are respectfully requested

6. Has your bank now under discount any bills receivable of the bank named, or any on which its official endorsement appears, or for which it is in any other way liable? If so, please furnish a list, giving names and amounts.

2 Does your bank now hold bills receivable on any securities belonging to the bank named, or any on which its official indorsement appears, or for which it is in any other way liable? If any are held, give list and state how they are held.

3. Are there any loans now outstanding by your bank to the bank named, or to any other party for which the bank is in any way liable? If so, specify character of loan—whether upon bills payable, certificate of deposit, prom account, etc. In such case specify amount, time, etc.

3. _____

4. Has your bank effected any loans for account of the bank named? If so, give names of borrowers and amounts, state how the notes are secured and whether or not the security is held by your bank.

4. _____

5. Please state when your account with the bank named was last reconciled. _____

6.

Boardman

Recovery

STATE OF ARKANSAS

Banking Department

City of Little Rock.

To the Cashier:

Sir: This circular is sent under instructions from the Banking Commissioner for the purpose of reconciling the account of the within-named bank with that of your bank at date of examination

You are respectfully requested to furnish fully the information asked for on the other pages of this circular and to forward same at your earliest convenience.

from whom this is received.

An address envelope for your reply is enclosed herewith.

W. T. Maxwell,
BANK COMMISSIONER

TO THE STATE BANK EXAMINER:

A Statement of the Account of The

rendered at the close of business on

showing a balance of \$

due from the

has been examined and

found correct, with exceptions (if any) noted below

Cashier.

STATE - FARMERS' TRUST CO., LINDSAY

DATE

DATE

We debit (not in their account):

We credit (not in their account):

Remittances in transit:

Drafts issued (outstanding):

They debit (not on our books):

They credit (not on our books):

Their Balance

Our Balance

Please fill out the above blank, and also report any counter entries appearing on the statement, not shown on your books.

FORM NO. 15-A—USED TO VERIFY BALANCES "DUE TO" BANKS

If the bank has out for collection items which are being carried as "items in transit" or "collection items," a verification should be made of these items by use of forms or letters similar to the one given below.

To the.....192..

The books of the.....
Bank of.....Arkansas, at the close of busi-
ness on the.....192..., shows that items
listed below have been forwarded to you for collection.

You are respectfully requested to verify this list, over the signature of some officer of your bank, and forward same at your earliest convenience to

An addressed envelope for your reply is enclosed herewith.

Very truly yours,

CHAS. MCKEE,
Bank Commissioner.

Date sent	Date or number of item	Description of item	Due	Amount
.
.
.
.
.

Cashier.

When a bank owes bills payable or has rediscounted notes, a copy of each note pledged as collateral or redis-

counted should be made, and retained in the note case with an endorsement thereon "pledged as collateral with bank to secure note of \$..... dated.....," or "rediscounted with..... bank, date rediscounted....." If such copies of notes pledged and rediscounted are kept, the committee can, by making lists of notes pledged or rediscounted and sending the lists to the holding banks, verify these notes.

*"Before transmitting a note for credit, proper arrangements should be made in advance. Entry should not be made on the books until after advices are received showing that the note has been accepted and your account has been actually credited with the amount. The amount must appear in your liabilities under the account of bills payable."

A note cannot be legally executed by any bank, nor its bills receivable rediscounted, until and unless authorized by the board of directors.

RESOLUTION AUTHORIZING BILLS PAYABLE

(Suggested form)

†"BE IT RESOLVED, That the president or vice-president and cashier or assistant cashier of this bank be, and they are hereby, authorized and empowered to execute a promissory note in the name of this bank payable thirty days from date for the sum of \$10,000.00 to the order of Bank with interest at the rate of per cent per annum and to pledge to the said Bank, as collateral security for the payment of such note, bills receivable or customers' notes representing the assets of this bank in the aggregate sum not exceeding approximately \$.....

*"Rules and Regulations," Banking Department of Oregon.

†"Rules and Regulations," Banking Department of Oregon.

BE IT FURTHER RESOLVED, That the president or vice-president and cashier or assistant cashier may obtain an extension of said notes or a renewal thereof in whole or in part upon receipt and consent therefor in writing from the said Bank, providing said note is not paid in full on or before the date of maturity; and provided further, that not more than one extension or renewal thereof shall be permitted without obtaining further authority from the board of directors.

BE IT FURTHER RESOLVED, That a certified copy of this resolution be prepared by the cashier and attached to said note as evidence of authority for the execution thereof and for pledging the collateral deposited as security therefor."

RESOLUTION AUTHORIZING REDISCOUNTS

(Suggested form)

*"BE IT RESOLVED, That the president or vice-president and cashier or assistant cashier of this bank be, and they are hereby authorized for the purpose of borrowing money to endorse and rediscount bills receivable or customers' notes of this bank not to exceed in the aggregate approximately \$..... and to deliver the same to the bank for rediscount and credit for the account of this bank from time to time when funds representing the proceeds of such rediscounts may be needed or required by this bank.

"BE IT FURTHER RESOLVED, That the president or vice-president and cashier or assistant cashier, as the case may be, are hereby further authorized to withdraw any of said notes or replace or substitute the same with other negotiable notes for like or similar amounts acceptable to said bank not to exceed in the aggregate the approximate sum of \$..... authorized by this

*"Rules and Regulations," Banking Department of Oregon.

resolution until the full amount due the said bank under such rediscounts has been fully paid and the obligations of this bank thereunder have been fully discharged.

"BE IT FURTHER RESOLVED, That a certified copy of this resolution be prepared by the cashier and attached to accompany said notes as evidence of authority to endorse and guarantee payment thereof and rediscount the same with the said bank for the respective and aggregate amounts represented thereby."

CAPITAL STOCK

The stock certificate book should be called for, and should be examined to see that surrendered certificates have been properly cancelled, and that all outstanding certificates have been receipted for. The committee should determine from the stubs of outstanding certificates whether the number of shares issued represent the amount of the paid up capital of the bank. Cancelled stock certificates should be securely attached to their respective stubs.

EXPENSE

Most banks keep a record showing the distribution of expenses. The committee should carefully examine this record, and if such a record is not kept they should examine the expense account of the bank to see that all items charged thereto are regular and not excessive.

FORM DE		SHEET NO. <u>16</u>		DISTRIBUTION OF EXPENSES														MONTH OF <u>May</u>		19 <u>21</u>	
NO.	DESCRIPTION	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	AMOUNT PAID	TOTAL			
	FORWARD																				
719	Office Exp. 16-20																				
720	Office Exp. 21-25																				
721	Office Exp. 26-30																				
722	Office Exp. 31-31																				
723	Office Exp. 1-5																				
724	Office Exp. 6-10																				
725	Office Exp. 11-15																				
726	Office Exp. 16-20																				
727	Office Exp. 21-25																				
728	Office Exp. 26-30																				
729	Office Exp. 31-31																				
730	Office Exp. 1-5																				
731	Office Exp. 6-10																				
732	Office Exp. 11-15																				
733	Office Exp. 16-20																				
734	Office Exp. 21-25																				
735	Office Exp. 26-30																				
736	Office Exp. 31-31																				
737	Office Exp. 1-5																				
738	Office Exp. 6-10																				
739	Office Exp. 11-15																				
740	Office Exp. 16-20																				
741	Office Exp. 21-25																				
742	Office Exp. 26-30																				
743	Office Exp. 31-31																				
744	Office Exp. 1-5																				
745	Office Exp. 6-10																				
746	Office Exp. 11-15																				
747	Office Exp. 16-20																				
748	Office Exp. 21-25																				
749	Office Exp. 26-30																				
750	Office Exp. 31-31																				
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793	Office Exp. 1-5																				
794	Office Exp. 6-10																				
795	Office Exp. 11-15																				
796	Office Exp. 16-20																				
797	Office Exp. 21-25																				
798	Office Exp. 26-30																				
799	Office Exp. 31-31																				
800	Office Exp. 1-5																				

FIDELITY BONDS

The committee should call for the bonds of the bank's employees. These bonds should be carefully read that the committee may be advised whether their terms are being complied with. Every employee of a bank who handles its cash or records should be adequately bonded. The directors of a bank should be advised as to the terms of fidelity bonds. Large losses have been sustained by banks because of non-compliance with the terms of fidelity bonds.

The burglary and hold-up insurance policies should also be called for and the committee should advise themselves whether the terms of these policies are being complied with, and whether the bank is carrying a sufficient amount of this class of insurance.

As stated at the beginning of this chapter the Examining Committee Report forms used by the various states are in no wise uniform. A very comprehensive report form is used by the State Banking Department of Arkansas which form is here reprinted in full. It will not conform to the requirements in all instances, but if it is studied an idea of the work to be done by an examining committee will be obtained. Many of the questions in this report are, in a way, not essential, but are suggestive as to methods which should be employed in keeping the records of a bank, and what directors should know about their bank.

State Banking Department
Little Rock, Ark.

REPORT OF EXAMINING COMMITTEE

OF THE

ARKANSAS

We, the undersigned, Examining Committee of the above named bank, report that on the _____ day of _____, 192____ we made our regular examination, having carefully counted the cash, made proofs, verified the Assets and Liabilities with the ledger balances, the results of which are given under the respective heads of this report.

We have answered the questions following in this report after a careful examination of the different accounts, and our answers are true and correct to the best of our knowledge and belief. Below is a general statement of the Assets and Liabilities of the bank as we found them on the date of the examination.

STATEMENT OF CONDITION OF BANK AT DATE OF EXAMINATION

RESOURCES	Dollars	Cts.	Dollars	Cts.
1. Loans and Discounts				
2. Loans on Real Estate				
3. Loans on Cotton				
4. Loans on Other Commodities				
5. Customers' Liability Accounts of "Acceptances" and "Letters of Credit" executed by this bank, and by Other Banks for Account of this Bank				
6. Overdrafts, Secured and Unsecured				
7. U. S. Securities				
8. Bonds to Secure Postal Savings				
9. Stock in Federal Reserve Bank				
10. Other Bonds and Securities, including State Warrants, County and City Scrip				
11. Furniture and Fixtures				
12. Banking House				
13. Other Real Estate				
14. Items in Transit on Sundry Banks				
15. Bills of Exchange				
16. Due from Banks, not Reserve Agents				
17. Cash Items, not including Checks on Other Banks in Same Town				
18. Due from Approved Reserve Agent Banks				
19. Due from Federal Reserve Bank				
20. Checks on Other Banks in Same Town				
21. Currency				
22. Gold				
23. Silver and Fractional Coin				
24. Other Resources				
Always verify and compare this TOTAL				
LIABILITIES			Dollars	Cts.
1. Capital Stock, Paid Up				
2. Surplus Fund, Certified				
3. Undivided Profits, Net				
4. Bills Payable				
5. Notes Redemanded				
6. Bills Payable "Deposits on which more than 4 Per Cent Interest is Paid"				
7. Savings Accounts				
8. Postal Savings Deposits				
9. Trust Funds				
10. Dividends Unpaid				
11. Individual Deposits				
12. Public Funds				
13. Due to Banks, not Reserve Agents				
14. Due to Reserve Agent Banks				
15. Demand Certificates of Deposit				
16. Time Certificates of Deposit				
17. Time Certificates Representing Money Borrowed				
18. Certified Checks				
19. Cashiers' Checks				
20-A. Total Amount of All Classes Deposits as Above Shown				
20-B. Net Deposits (after deducting amount on which more than 4 per cent is paid as shown, in Item 6)				
21. Bonds Borrowed				
22. Reserved for Interest				
23. Reserved for Taxes				
24. Letters of Credit and Acceptances Executed for Customers				
25. Other Liabilities				
Always verify and compare this TOTAL				

This examination is to be made by a committee of directors or other persons designated by the board, but not by officers. The report is to be presented to the board for its acceptance and to be signed by the directors present at such meeting.

NOTE PROVISION FOR MINORITY REPORT

0

List all outstanding and unpaid loans to your directors, officers or employees on which any such director, officer or employee is endorser, surety or guarantor, or to any firm, copartnership, or corporation of which such director, officer or employee is a member or stockholder.

To the best of your knowledge and belief, are there any loans carried by the bank which are made for the accommodation of a director, officer or employee or a firm, copartnership or corporation in which a director, officer or employee is interested but which

2. Did you make a proof of all loans and discounts and did the total agree with the totals carried in your general ledger and daily balance sheet?

List all such loans and give complete details.

3 Are all the securities pledged as collateral for your loans in the custody or control of the bank?

4. Are there any agreements or understandings, verbal or otherwise, in reference to any notes due your bank, not clearly shown by the notes and records? _____

6. Has your bank loaned to any individual, firm, copartnership or corporation, directly or indirectly or by accommodation or otherwise, an amount or amounts in excess of 10% of the bank's Capital and Certified Surplus as permitted by law? (Sec. 698 Crawford & Mosses' Digest) _____ If so, list same, giving amounts _____

8. Do you know of any loans to individuals, firms, companies or corporations which appear on the books of the bank in the name of other than the actual borrower? _____

If so, give full particulars.

7. To the best of your knowledge and belief is the bank liable in any way on loans or other securities placed with other banks or sold to individuals, other than the liabilities of this character shown on the books? _____

8. Does the cashier submit a written list of loans and investments made and are loans to officers and directors authorized by special resolution of the board of directors and resolution recorded in the minutes? _____

9. Does the cashier submit all past due notes, renewals and extensions of notes at each monthly board meeting, for approval?

UNSECURED LOANS.

I. Is it your practice to obtain financial statements of borrowers previous to making unsecured loans?

2. Are such financial statements properly filed and renewed at sufficient intervals to keep you closely in touch with the affairs of the borrower?

1. List any commercial or other unsecured paper past due twelve months, on which the interest is unpaid and which is not in process of collection. (Sec. 704-717 (3) Crawford & Moses' Digest)

BAD AND DOUBTTUL LOANS

[illegible]

(Note—Make a check mark (✓) before loans listed in the above schedule that you recommend to be charged off).

4. List any notes given in payment of interest.

5 Does the bank keep a liability ledger? _____

REAL ESTATE LOANS

1. Are signed appraisals filed in connection with each loan secured by real estate showing the value of the real estate and the value of improvements securing the said loan? _____

2. List any loans on real estate carried as an asset for an amount in excess of sixty per centum of the market value of your security _____

3. List any loans secured by second mortgage on real estate _____

4. Have you evidence of good title on file in connection with each loan on real estate to show the status of your lien? _____

(A) If such evidence of title consists of an abstract, is such abstract accompanied by written opinion showing priority of your lien _____

5. List any loans secured by real estate which for any reason should be collected _____

6. List any loans secured by real estate on which interest has not been paid for a period of one year or more _____

7. Are the improvements on the property securing your loans on real estate covered by fire insurance and are the policies held by you with mortgage clause attached thereto, making loss if any, payable to you? _____

LOANS SECURED BY STOCKS, BONDS AND OTHER COLLATERAL

1. Is the collateral to all loans properly assigned or endorsed? _____

2. Has the statutory lien been waived on all Arkansas Corporation stocks which are held as collateral to loans? _____

3. List any loans secured by collateral which are insufficiently secured, giving in each case amount of loan with description and value of collateral _____

4. List any loans of this character which should be collected _____

LOANS ON COTTON AND OTHER COMMODITIES

1. Are loans of this class properly secured in accordance with Sec 698 Crawford & Moses' Digest, which provides for 10 per centum margin in security and insurance, with loss payable to bank, for full amount of loan? _____

2. Are loans of this class supported by special written agreement from borrower, providing for sale of collateral in case of depreciation of collateral and failure by borrower to restore margin? _____

3. Have you the warehouse receipts or bills of lading securing these loans in your possession or control? _____

4. Are you advised as to the class and grade of commodity and actual market value of same securing these loans? _____

5. Are these commodities insured for full amount of your loans on them and are the policies of insurance held by you with loss, if any, payable to your bank? _____

OVERDRAFTS

1. Did you verify a list of all accounts overdrawn in the individual ledgers and did the totals agree with the amount carried in the general ledger and daily balance sheet? _____

2. Are overdrafts habitually granted? _____

3. List accounts that are habitually overdrawn _____

4. State conditions under which overdrafts are permitted, if at all _____

5. Give names and amounts of overdrafts considered doubtful or worthless _____

6. Are all checks overdrawing accounts referred to the proper officers before being honored? _____

7. Is a list of overdrafts submitted at each board meeting and are they approved by the Board of Directors? (See Sec 99)

Crawford & Moses' Digest)

BONDS AND SECURITIES

Face Value		Carried at	Market Value
	United States Securities		
	Municipal Bonds		
	State, County and School Warrants		
	City Warrants		
	Special Improvement District Bonds		
Par Value	CORPORATION STOCKS AND BONDS		

BONDS AND SECURITIES

1. Did you verify the bonds and other securities carried by the bank and did you find that all of said bonds and other securities were on hand or under control of the bank? _____

2. Have any bonds or other securities been sold by the bank under a repurchase agreement? _____

BANKING HOUSE, FURNITURE AND FIXTURES

	Amount at Which Carried on Books	Estimated Value
Banking House		
Furniture and Fixtures		
Total		

OTHER REAL ESTATE OWNED

Describe Character of Property, as "Farm," "Residence," etc.	Date Acquired	Amount at Which Carried on Books	Estimated Value
Total			

1. In your opinion are banking house, furniture and fixtures, and other real estate, being carried on the books in amounts in excess of their actual value? If so, make recommendations as to proper reductions _____

2. Give amount of fire insurance carried on banking house and furniture and fixtures _____

CASH ITEMS

1. Do the officers watch this account carefully and are they familiar with all items contained therein? _____

2. Did you find any checks of individual customers carried in this account to avoid overdrafts? _____

3. Were all items of temporary character? _____

4. Were there included any items which should be charged to expense? _____

5. Were there any items in this account evidencing a liability of any officer or employee of the bank? _____

6. Describe fully any irregular items found _____

CASH

1. Did you count the cash, and did it agree with the amount as shown on the daily statement and cash book? _____

2. Does the teller's cash book show a permanent record of the cash and is it written up in ink each day? _____

3. Are over and shorts carried as cash or are they shown in your general ledger and daily statement as such? _____

DUE FROM BANKS

1. Did you reconcile your accounts with correspondents and verify all items in process of collection? _____
2. Are the bank's accounts with correspondents reconciled each month and records of same made in reconciliation book? _____
3. Were accounts with correspondents in balance at time last statement was rendered? If not give differences _____

EXPENSE

1. Did you carefully examine the expense account? _____
2. Did you approve of all items charged thereto? _____
3. Are all items approved by your officers before being charged to this account? _____
4. Are there any excessive items charged to expense? _____
5. Are your expenses out of proportion to your income? _____

CAPITAL STOCK

1. Are you carrying as part of your assets any notes given in payment of your capital stock? _____
2. Do you hold any shares of your capital stock as collateral to loans or in any way control shares of your stock in connection with any money advanced? _____
3. Are you carrying any loans for stockholders, depending on the stock to liquidate the loan? _____
4. To the best of your knowledge and belief, is the Capital Stock of the bank owned as shown by the stock book and ledger? _____
5. Does the bank own any of its own stock? If so explain how obtained _____
6. In your opinion, is every stockholder able to meet his or her double liability? _____

DEPOSITS

1. Did you make a proof of the individual and savings ledgers, certificates of deposit, cashier's checks and certified checks outstanding, and did these amounts agree with the totals appearing in your general ledger and daily balance sheet? _____
2. Are you familiar with the terms and agreements under which state, county, municipal and improvement district funds are deposited with your bank? _____
3. Are the ledgers properly posted? _____
4. Are the duties of the bookkeepers occasionally interchanged without previous notice? _____
5. In balancing pass books or making up statements are the same compared with the individual ledger by a person other than the one making entry on such ledger? _____
6. Are the ledgers occasionally pulled by some person not regularly keeping them? _____
7. Are paid certificates of deposit and cashier's checks properly cancelled and filed in numerical order? _____
8. Give rate of interest paid on:
 - (a) Daily balances _____
 - (b) Savings accounts _____
 - (c) Time certificates _____
 - (d) Public funds _____

BILLS PAYABLE

To Whom Issued	Amount	Date	Time	Rate of Interest	SECURITY		Amount of Certificates of Deposit Issued for Money Borrowed
					Kind	Total Amount	

NOTES REDISCOUNTED

Rediscounted With	Date Due	Amount	Amt. of Notes or Securities Pledged, or Sold With Agreement to Re-purchase

1. Were the above Bills Payable or Rediscounts properly authorized by the Board of Directors and copy of resolutions recorded
in Minute Record? _____

2. Are copies of all notes pledged or rediscounted kept? _____

3. Are payments on notes pledged or rediscounted noted on copies and amount of payments remitted to pledgees? _____

OTHER RESOURCES

Describe fully _____

OTHER LIABILITIES

Describe fully _____

MISCELLANEOUS

1. Has the bank any assets not shown on its books? If so, list same and give value. _____

2. Has the bank any liabilities not shown on its books? If so, give same. _____

3. Did you carefully compute the legal reserve carried for the thirty days preceding the examination and did it meet the legal requirement? _____

4. Are the books and accounts properly and correctly kept, so as to enable you to make an intelligent examination? _____

5. Are the officers complying with the provisions of the State Banking Law and the rules and regulations of the Bank Commissioner? _____

6. As far as you can determine, is the bank in a sound and satisfactory condition? _____

7. Are all employees of the bank, handling its funds or records, bonded? _____

8. Have you examined bonds of employees, burglary insurance and fire insurance policies? _____

9. In whose possession are they? _____

10. Has the bank any hidden profits? If so state amount and how earned. _____

11. Make any recommendations you may have for changes or improvements of any character. _____

Respectfully submitted,

Examining
Committee

We, the undersigned Directors of the above named bank, being present at a meeting of the Board held _____

_____ 19____ do hereby certify that the foregoing report of our Examining Committee was read at said meeting, adopted and made a part of the minutes. We further certify that we have carefully examined this report and are satisfied that it gives the true and exact condition of the bank, that the criticisms are just and the recommendations good, and that we will endeavor to comply with same at the earliest possible moment.

DIRECTORS

(Note—If for any reason any Director does not approve of the criticisms or recommendations made, or is not fully satisfied that the report reflects the true and exact condition of the bank, let him state exceptions or objections in writing, in space provided for minority report)

The original of this report was made a part of the minutes, as above stated, and a copy, duly signed, mailed to the State Bank Commissioner _____, 19____.

_____, President.

_____, Cashier.

MINORITY REPORT OR REMARKS BY INDIVIDUAL DIRECTORS

1. Introduction
 2. Background
 3. Methodology
 4. Results
 5. Conclusion
 6. References
 7. Appendix
 8. Index
 9. Table of Contents
 10. Figure 1
 11. Figure 2
 12. Figure 3
 13. Figure 4
 14. Figure 5
 15. Figure 6
 16. Figure 7
 17. Figure 8
 18. Figure 9
 19. Figure 10
 20. Figure 11
 21. Figure 12
 22. Figure 13
 23. Figure 14
 24. Figure 15
 25. Figure 16
 26. Figure 17
 27. Figure 18
 28. Figure 19
 29. Figure 20
 30. Figure 21
 31. Figure 22
 32. Figure 23
 33. Figure 24
 34. Figure 25
 35. Figure 26
 36. Figure 27
 37. Figure 28
 38. Figure 29
 39. Figure 30
 40. Figure 31
 41. Figure 32
 42. Figure 33
 43. Figure 34
 44. Figure 35
 45. Figure 36
 46. Figure 37
 47. Figure 38
 48. Figure 39
 49. Figure 40
 50. Figure 41
 51. Figure 42
 52. Figure 43
 53. Figure 44
 54. Figure 45
 55. Figure 46
 56. Figure 47
 57. Figure 48
 58. Figure 49
 59. Figure 50
 60. Figure 51
 61. Figure 52
 62. Figure 53
 63. Figure 54
 64. Figure 55
 65. Figure 56
 66. Figure 57
 67. Figure 58
 68. Figure 59
 69. Figure 60
 70. Figure 61
 71. Figure 62
 72. Figure 63
 73. Figure 64
 74. Figure 65
 75. Figure 66
 76. Figure 67
 77. Figure 68
 78. Figure 69
 79. Figure 70
 80. Figure 71
 81. Figure 72
 82. Figure 73
 83. Figure 74
 84. Figure 75
 85. Figure 76
 86. Figure 77
 87. Figure 78
 88. Figure 79
 89. Figure 80
 90. Figure 81
 91. Figure 82
 92. Figure 83
 93. Figure 84
 94. Figure 85
 95. Figure 86
 96. Figure 87
 97. Figure 88
 98. Figure 89
 99. Figure 90
 100. Figure 91
 101. Figure 92
 102. Figure 93
 103. Figure 94
 104. Figure 95
 105. Figure 96
 106. Figure 97
 107. Figure 98
 108. Figure 99
 109. Figure 100
 110. Figure 101
 111. Figure 102
 112. Figure 103
 113. Figure 104
 114. Figure 105
 115. Figure 106
 116. Figure 107
 117. Figure 108
 118. Figure 109
 119. Figure 110
 120. Figure 111
 121. Figure 112
 122. Figure 113
 123. Figure 114
 124. Figure 115
 125. Figure 116
 126. Figure 117
 127. Figure 118
 128. Figure 119
 129. Figure 120
 130. Figure 121
 131. Figure 122
 132. Figure 123
 133. Figure 124
 134. Figure 125
 135. Figure 126
 136. Figure 127
 137. Figure 128
 138. Figure 129
 139. Figure 130
 140. Figure 131
 141. Figure 132
 142. Figure 133
 143. Figure 134
 144. Figure 135
 145. Figure 136
 146. Figure 137
 147. Figure 138
 148. Figure 139
 149. Figure 140
 150. Figure 141
 151. Figure 142
 152. Figure 143
 153. Figure 144
 154. Figure 145
 155. Figure 146
 156. Figure 147
 157. Figure 148
 158. Figure 149
 159. Figure 150
 160. Figure 151
 161. Figure 152
 162. Figure 153
 163. Figure 154
 164. Figure 155
 165. Figure 156
 166. Figure 157
 167. Figure 158
 168. Figure 159
 169. Figure 160
 170. Figure 161
 171. Figure 162
 172. Figure 163
 173. Figure 164
 174. Figure 165
 175. Figure 166
 176. Figure 167
 177. Figure 168
 178. Figure 169
 179. Figure 170
 180. Figure 171
 181. Figure 172
 182. Figure 173
 183. Figure 174
 184. Figure 175
 185. Figure 176
 186. Figure 177
 187. Figure 178
 188. Figure 179
 189. Figure 180
 190. Figure 181
 191. Figure 182
 192. Figure 183
 193. Figure 184
 194. Figure 185
 195. Figure 186
 196. Figure 187
 197. Figure 188
 198. Figure 189
 199. Figure 190
 200. Figure 191
 201. Figure 192
 202. Figure 193
 203. Figure 194
 204. Figure 195
 205. Figure 196
 206. Figure 197
 207. Figure 198
 208. Figure 199
 209. Figure 200
 210. Figure 201
 211. Figure 202
 212. Figure 203
 213. Figure 204
 214. Figure 205
 215. Figure 206
 216. Figure 207
 217. Figure 208

CHAPTER NINE

THE BANK STATEMENT

BROADLY speaking, the functions of a bank are to receive deposits, make loans, transfer money and credit, and in the case of national banks, to issue currency. Although banks carry on many other lines of business, in the final analysis, these are their real functions.

For the purpose of discussing banking functions, the items of resources and liabilities in the report of national banks to the Comptroller of the Currency will be used. Not all of the items referred to here will be found in the statements of state banks and not all of them will be found carried by all national banks. Only a short discussion of each item contained in the statement will be undertaken, for it is not the purpose of this book to be a treatise on the functions and detailed operations of banks, but rather to refer to them in their relation to the duties, responsibilities and liabilities of bank directors.

LOANS AND DISCOUNTS

This asset is, in nearly every instance the most important in the statement as far as the solvency of the bank is concerned, for loans and discounts almost universally comprise a larger percentage of the total resources of a bank, and if worth the amount at which carried the bank is usually solvent.

The loans and discounts of a bank may be composed of

IN THE STATE OF

AT THE CLOSE OF BUSINESS ON

RESOURCES		DOLLARS	Cts.
1. Loans and discounts, including rediscounts, acceptances of other banks, and foreign bills of exchange or drafts sold with indorsement of this bank (except those shown in 5 and 6)			
5. Acceptances of other banks discounted			
6. Customers' liability account of acceptances of this bank purchased or discounted by it.			
Total loans			
2. Overdrafts, secured, \$			
3. Customers' liability account of "Acceptances" executed by this bank and by other banks for account of this bank, and now outstanding			
4. Liability of foreign banks and bankers for drafts and bills accepted by this bank to create dollar exchange, and now outstanding			
7. U. S. Government securities owned:			
a. Deposited to secure circulation (U. S. bonds par value)			
b. All other United States Government securities (including premiums, if any)			
Total			
8. Other bonds, stocks, securities, etc.			
9. Banking House, \$			
10. Real estate owned other than banking house			
11. Lawful reserve with Federal Reserve Bank			
12. Items with Federal Reserve Bank in process of collection			
13. Cash in vault and amount due from national banks			
14. Amount due from State banks, bankers, and trust companies in the United States (other than included in Items 8, 9, and 10)			
15. Exchanges for clearing houses			
16. Checks on other banks in the same city or town as reporting bank (other than Item 12)			
Total of Items 9, 10, 11, 12, and 13.			
17. Checks and drafts on banks (including Federal Reserve Bank) located outside of city or town of reporting bank			
18. Miscellaneous cash items			
19. Redemption fund with U. S. Treasurer and due from U. S. Treasurer			
20. Other assets, if any			
TOTAL			
LIABILITIES		DOLLARS	Cts.
21. Capital stock paid in			
22. Surplus fund			
23. Undivided profits:			
a. Reserved for interest and taxes accrued			
b. Reserved for:			
c. Less current expense, interest, and taxes paid			
24. Circulating notes outstanding			
25. Amount due to Federal Reserve Bank (deferred credits)			
26. Amount due to national banks			
27. Amount due to State banks, bankers, and trust companies in the United States and foreign countries (other than included in Items 21 or 22)			
28. Certified checks outstanding			
29. Cashier's checks outstanding			
Total of Items 21, 22, 23, 24, and 25			
30. Demand deposits (other than bank deposits) subject to Reserve (deposits payable within 30 days)			
31. Individual deposits subject to check			
32. Certificates of deposit due in less than 30 days (other than for money borrowed)			
33. State, county, or other municipal deposits secured by pledge of assets of this bank or surety bond			
34. Deposits requiring notice, but less than 30 days			
35. Dividends unpaid			
36. Other demand deposits			
Total of demand deposits (other than bank deposits) subject to Reserve, Items 26, 27, 28, 29, 30, and 31.			
37. Time deposits subject to Reserve (payable after 30 days, or subject to 30 days or more notice, and postal savings)			
38. Certificates of deposit (other than for money borrowed)			
39. State, county, or other municipal deposits secured by pledge of assets of this bank or surety bond			
40. Other time deposits			
Total of time deposits subject to Reserve, Items 32, 33, 34, and 35.			
41. United States deposits (other than postal savings), including War Loan deposit account and deposits of United States disbursing officers			
42. U. S. Government securities borrowed			
43. Bonds and securities, other than United States, borrowed			
44. Bills payable (including all obligations representing money borrowed other than rediscounts)			
45. Notes and bills rediscounted, including acceptances of other banks and foreign bills of exchange or drafts sold with indorsement of this bank			
46. Letters of Credit and Travelers' Checks sold for cash and outstanding			
a. "Acceptances" executed by this bank for customers, and to furnish dollar exchange			
b. Less acceptances of this bank purchased or discounted (see Item 1 c)			
47. Acceptances executed by other banks for account of this bank			
48. Liabilities other than those above stated			
TOTAL			

COPY ALL SIGNATURES.

MAKE MARK
FOR NOTARY'S SEAL.

STATE OF _____ COUNTY OF _____

I, _____ Cashier of the above-named bank, do solemnly swear that the above statement is true to the best of my knowledge and belief.

Subscribed and sworn to before me this _____ day _____, 1923.

Notary Public,

Director.

one or more classes of paper: time loans, demand loans, call loans, investment loans, industrial loans, capital loans, mortgage loans, single and double named paper, loans on warehouse receipts or bills of lading, loans on open book accounts, loans on insurance, loans on chattels, discounted acceptances of other banks or of individuals, as well as other classes.

A discussion of the desirability of the various classes of loans will not be undertaken but it should at all times be remembered that the most desirable class of loans for a commercial bank is one which, through the usual course of business, will be self liquidating.

In making a loan numerous things must be taken into consideration of which the three most important are the character of the borrower, collateral or security offered, capacity or ability of the borrower to re-pay.

Concerning the maker of a note, his integrity, prudence, industry and ability should of course be favored. At times loans are made upon a "good endorsement" when the maker of the note is not good. It is bad business to make any loan knowing that within all probability the surety will have the loan to pay. It is also bad business to make loans on collateral or other security when it is probable the security will have to be taken to liquidate the debt. In the instance of the endorser, the bank almost invariably makes an enemy, for surety debts are hard to collect and it is seldom, if ever, desirable for a bank to "buy" a law suit. No loan should be made on collateral, the value of which is unknown, or which is known to be doubtful.

If a note is unsupported by security the lending bank should know the financial standing of the borrower. Too often loans are made without a definite knowledge concerning the financial responsibility of the borrower, when a financial statement, if required, would reveal that he is

not entitled to a loan as large as he has requested, and often to none at all. The importance of financial statements cannot be overestimated. A letter of the Comptroller of the Currency dated June 20, 1922, will emphasize this:

"To the Board of Directors of all National Banks.

"The necessity of requiring financial statements from all borrowers has long been apparent to this office and an endeavor has been made to impress upon the managements of National Banks the importance of this matter, by having the examiners discuss it with the directors while in the bank. All banks, however, have not as yet adopted the practice of requiring such statements.

"This office, the State Banking Department, and the Bankers Association of Nebraska, have united in requesting all banks in Nebraska to obtain from borrowers of \$500 or more, whose loans are not adequately secured by liquid collateral, a satisfactory financial statement upon which to base accommodations extended.

"It is desired that National Banks in other states shall also adopt this practice, and you are requested and urged, therefore, to put this plan into operation.

"Please acknowledge receipt of this letter and advise what will be done in the premises.

Respectfully,

D. R. CRISSINGER, *Comptroller.*"

"A very common error is made by those who do not think carefully when they complain that the banks are only loaning money to certain classes. For example, the farmer may think that the bank is only loaning money to the town merchants. As a matter of fact, good farmer paper is more highly prized in banks than is merchant paper. Neither one is good unless it is properly secured. The banker must not loan funds to either merchant or farmer unless he is sure he can get them back. If he fails he is

unfaithful to his depositors and those are the ones to whom he is responsible. He must loan his money to his depositors or to those who will be his depositors as soon as they are able to be. He is not justified in loaning the depositors money for the "good of the town" or even for the welfare of the community. Let all enthusiastic boosters and promoters take notice of this fact."*

Each loan should be made with a view of increasing the business of the bank. Political, religious, social and fraternal relations should have no weight whatever in determining the advisability of making a loan.

ACCEPTANCES OF OTHER BANKS DISCOUNTED

The Federal Reserve Act, the National Bank Act and the laws of some states permit banks to "accept," within well defined limits, time drafts drawn against actual business transactions. Often banks discount "acceptances" of other banks, and at times purchase their own "acceptances," in which instances they are carried as items 1b and 1c (see items under resources) as the case may be.

It is customary for the party for whom these acceptances are executed to secure the bank, there being a liability of this party to the bank. The obligation of this party is therefore carried as an asset (3a) "Customers' Liability Account of Acceptances executed by the bank." Also, under the Federal Reserve Act, under certain prescribed limits, banks are permitted to "accept" drafts and bills to create dollar exchange. The liability of the customer for these acceptances is carried by the bank as an asset (3b).

The liabilities of the bank on account of it having "accepted" time drafts or drafts and bills to create dollar exchange are shown as such under items 42a and 42b of the statement (see items under liabilities).

**Chicago Banker*, June 30, 1921, W. Y. Morgan.

OVERDRAFTS

Overdrafts are, in most instances, loans without security or written contract. Often the plea is made that overdrafts cannot be eliminated from a bank because of competition. However, there are striking instances where, with the keenest of competition, banks have practically eliminated them. Usually when this is done it reflects in a most favorable way, for the public respects a banker who conducts a clean bank, and although they may not like the banker personally, do business with his bank because "he knows his business."

It is very probable that an analysis of the overdrafts of most banking institutions will show that a large part, both in number and amount, are of the same customers month after month. In a large measure overdrafts are the result of indulgence by the banker. The customer who habitually overdrafts is worth little if anything, and the bank would be better off if such customers would move their "bank accounts."

*"The practice of permitting overdrafts is undesirable. Every bank should discourage this habit among customers. It is very largely a matter of educating the public in transacting a banking business. Many banks have become careless in this respect, and have permitted their customers to abuse the overdraft privilege.

"One bank in this State had notices printed for the purpose of notifying all customers who are in the habit of overdrawing their accounts, and on the bottom portion thereof reproduced a letter from this department which appeared as follows:

"The practice of extending accommodations to customers by permitting overdrafts is disapproved and will no longer be countenanced by this department. Section 191

*"Rules and Regulations," Banking Department of Oregon.

of the Banking Laws, revision of 1921, makes it a misdemeanor for any person to draw a check against his account where there are not sufficient funds, and provides a penalty of imprisonment for a period of one year and a fine of \$1,000, or both such fine and imprisonment. You are requested therefore to discontinue the practice of permitting overdrafts, and hereafter you will please refuse payment of checks drawn by a customer on your bank unless there are sufficient funds on deposit or available for that purpose.

"You will present for adoption by the board of directors a resolution in harmony with these instructions and transmit a copy thereof to this department.

"In cities or towns having two or more banks this department recommends that the practice of permitting overdrafts should be entirely eliminated by mutual agreement, which should be adhered to strictly by all banks which become a party hereto. This is the most feasible solution of the overdraft problem. Your best efforts and coöperation are invited to discourage this undesirable practice."

*"Allowing patrons to control the reserve of the bank by habitual overdrafts is a practice out of harmony with sound business principles and should, therefore, be condemned. Banks ought to stand together against this evil. The rule of this office is to require the prompt collection, or charging off, of all overdrafts standing on the books over thirty days."

In some sections of the country overdrafts are used in extending lines of credit, in order that the lines may be more flexible. This is particularly true in some cotton sections, where the cotton buyers and cotton merchants buy and sell cotton every day. In such cases it is customary to require a contract of the customer using this form

*"Pointers, Suggestions and Model By-Laws," Illinois State Banking Department.

of credit, specifically setting out that the customer is liable for all advances. Where overdrafts are used in this manner for extending lines of credit, the lending bank requires security with ample margin to protect it against market fluctuation on the commodity for which advances are made.

UNITED STATES GOVERNMENT SECURITIES

This item needs little explanation, for since the late World War most people are more or less familiar with this class of securities. However, in accordance with the National Bank Act, National Banks are permitted to issue "circulating notes" which must be secured by certain classes of U. S. Bonds viz., 2% Consols of 1930, 2% Panamas of 1936 and 1938 and "Old Fours" of 1925, which bonds are deposited with the Treasurer of the United States by the issuing bank.

OTHER BONDS, STOCKS AND SECURITIES

Under this is included State, County, Municipal, Special Improvement, Railroad and Industrial bonds and all other classes of bonds and stocks. No attempt will be made to analyze the various classes of bonds and other securities nor to point out those which are desirable or undesirable investments.

The laws of the various states differ in respect to these assets which a bank may purchase. In some states banks may purchase only such classes of bonds as are specified by the law; in some states certain classes of bonds must be purchased as investments for savings and trust funds while in some states no such requirements are made; in some states banks cannot purchase stocks, while in others they may purchase certain classes of stocks as defined by law. In all the states, and under the National Bank Act, banks may acquire any class of stocks and bonds on account of

debts previously contracted, but provisions are made for prompt disposal of securities thus obtained.

Great care should be used in selecting these securities, or undesirable stocks and bonds may be acquired and even losses sustained. If a bank is in the market for this class of investments the officers, if they are not experts in this class of securities, should go to some bank, banker or reputable bond house and employ their services in making selections rather than attempting to purchase the securities without expert knowledge or advice.

*"When bonds are purchased through strangers, or through sources not known to be responsible, a notation should be made on the register or attached to the bonds, showing from whom the same were purchased. This is one means of proper identification in the event of your innocently purchasing stolen goods. The frequent forgeries, hold-ups, and larceny of Government Bonds is a sufficient warning for the exercise of great care. An accurate and complete record of bonds, warrants, and similar securities is your only protection for recovery under your insurance should your bank be held up, robbed, or burglarized."

BANKING HOUSE, FURNITURE AND FIXTURES

Banking Houses vary from small frame buildings, merely large enough for the transaction of business, to skyscrapers costing millions of dollars. In the discussion of the banking house, "furniture and fixtures" will also be considered. No iron-clad rule can be laid down governing these items, for communities and conditions vary so widely that each case must be given special consideration. However, a few general observations and suggestions can be made.

The first consideration is the location of the bank. It, of course, should be situated in the most accessible place, espe-

*"Rules and Regulations," Banking Department of Oregon.

cially is this true if there are two or more banks in the same town. Sometimes it is found that a bank building has been erected in a certain place because of the interests of some of the large stockholders with the hope that having the bank so located, the business of the town will be drawn in that direction. This is usually on account of a selfish interest, because this stockholder owns real estate close by which he desires to have enhanced in this way.

Some time ago a bank located in a town of about 3500 decided to erect a new banking house. This bank had a very good location but the president of the bank owned considerable property several blocks away from the center of the business district. The new bank building was erected on the president's lots, which he sold to the bank. An excellent building was erected at a cost of about \$50,000, but the business of the town did not move with the bank. After two or three years the bank's business was decreased to such an extent that its board of directors deemed it advisable to move nearer to the business center of the town, and it was necessary to sacrifice the bank building at a price of about \$20,000.

In erecting a building the question often arises whether or not it should be constructed only for the use of the bank in carrying on its business, or whether offices for renting should also be provided. The size of the town or city must be taken into consideration as well as the location of the bank building in determining this question. In the smaller towns it is seldom profitable for the bank to erect a building to be used for other purposes than for the banking house itself.

Too large a percentage of the bank's capital should not be invested in a building, which is often the case when a building is erected suitable for offices or store rooms in addition to the banking room. In any event the building

should be dignified and comfortable. If it is only leased the same matters should be taken into consideration.

Furniture and fixtures range from the cheapest "home-made" to the "finest marble."

The care of the banking room and furniture and fixtures is a matter that does not have the attention it should have, especially in the smaller institutions. Often the lobby and customers' desks are so dusty and dirty that the customers cannot use them. If the customers of some banks were permitted to go behind the fixtures and see the accumulation of worthless papers, dust, and old records hidden there, they would leave the bank in disgust, never to return. There is no excuse for this condition and little as the officer in charge may suspect, these things reflect his method of banking and record keeping.

Many banks in the smaller towns and even in some of the cities are using the lobbies of their banking rooms and their directors' rooms to a great advantage in advertising, by fitting up these rooms to be used by organizations as meeting places, and for rest rooms for their customers.

*"Any bank which may purchase or construct its own bank building will be required to limit the amount of investment for this purpose under the provisions of Section 29 of the Banking Laws, Revision of 1921, which, among other things, provides that a bank may hold such real estate as shall be necessary in which to transact the business of any such bank, including its banking offices and other premises in the same buildings, to rent as a source of income, but which shall not exceed in cost to such bank 50% of its paid-in capital and surplus.

"The physical appearance of a bank should be just as clean as the assets which represent the investment of its funds. Every bank, no matter how small, should present

*"Rules and Regulations," Banking Department of Oregon.

an inviting appearance. The desks and counters should be kept clean and all books and papers properly filed away.

"A banking room should be inviting to customers. When they come into the bank to transact business they should not be required to clean the dust from the benches or counters with their sleeves or trousers. There is no reason why a banking room cannot be clean. The fixtures may not be elaborate, the windows may not be French plate glass, but there is no reason why they should not be kept in a clean condition.

"Examiners will be requested to observe the appearance of bank premises and report such conditions to this department. Their assistance may be requested, when necessary, in providing convenient methods whereby books, papers and accumulations may be properly filed away.

"When new furniture or fixtures are installed in any bank a charge should be made against the furniture and fixture account for actual purchase price involved, based upon the invoices. The cost of transportation and installation should be charged to expense.

"There is no law which fixes the amount a bank is authorized to invest in furniture and fixtures, but the department will require, as a matter of administration, that such investments be consistent. Any bank investing excessive amounts for this purpose will be required to reduce the same to reasonable values. In all cases provision must be made for annual reductions, as a depreciation, until the furniture and fixtures appear in the assets at the actual cash market value or less. Annual reductions as depreciation should be made in at least such amounts as may be recognized by the Government in the preparation of income tax reports, which are submitted at the end of each calendar year."

*"These items are generally considered the slowest and often the least desirable of a bank's assets. Banks, especially young organizations, or concerns that have not accumulated a surplus, are warned against investing too liberally in resources of this character. The department urges periodical reduction in value by writing off to profit and loss, particularly in case of furniture and fixtures, and where an abnormal amount is invested in the bank building."

OTHER REAL ESTATE

The laws of some states allow banks and trust companies to buy and sell real estate other than that used for banking house purposes. Most of the state laws, as well as the National Bank Act, prohibit banks from dealing in other real estate. The laws of such states, as well as the National Bank Act, provide that in case other real estate is acquired on account of debts previously contracted, it must be disposed of within a specified time, or charged out of the assets of the bank. The time allowed for disposing of other real estate varies from one year in some states to seven years in others.

Other real estate is a slow asset, and usually the return on the amount invested is small. Therefore it should be disposed of as promptly as possible, and not held anticipating a profit.

LAWFUL RESERVE WITH FEDERAL RESERVE BANK

All National banks and those state banks which are members of the Federal Reserve System must carry a reserve (deposit) with the Federal Reserve Bank of the district in which the member bank is located. For banks

*"Pointers, Suggestions and Model By-Laws," State Banking Department of Illinois.

located in Central Reserve Cities, New York and Chicago, the reserve requirement is 13% of demand deposits and 3% of time deposits. For banks in Reserve Cities the reserve requirement is 10% of demand deposits and 3% of time deposits. For banks located in cities other than central reserve and reserve cities, the reserve requirement is 7% of demand deposits and 3% of time deposits. Many of the states, but not all of them, have passed laws making the reserve requirements of the Federal Reserve System the legal reserve for member state banks.

Only actual collected balances with the Federal Reserve Bank are considered lawful reserves and items that must be sent by the Federal Reserve Bank to other cities for collection are "deferred," reserve credit being given 1, 2, 3, 4, or 5 days later, according to the time required to make collections. The total of these items is shown as "9. Items with Federal Reserve Bank in Process of Collection." (See National Bank Statement—Resources.)

AMOUNT DUE FROM OTHER BANKS

Practically every bank, whether state bank member of the Federal Reserve System, National Bank, or non-member state bank, carries balances with banks other than the Federal Reserve. These balances of national or state member banks cannot be counted as legal reserve. The laws of the various states differ in their reserve requirements, but the Supervisor of Banks of most states is required to designate, under certain regulations of law, banks in which state banks may deposit their legal reserves—or at least a certain part of it. So, banks may have balances with "Reserve Agents" and "Non-Reserve Agents." These balances together with the actual cash on hand are the funds for the transaction of daily business. It will be seen, therefore, that care should be used in selecting a bank's Reserve

Agent or other depository, not only as to solvency, but also on account of accommodations that may be needed from time to time.

EXCHANGES FOR CLEARING HOUSE

This term is used for checks and other items received in the course of a day's business to be presented to the Clearing House the next morning for clearance or payment. Should there be no Clearing House in the city, these items would come under the following head:

CHECKS ON OTHER BANKS IN SAME TOWN

These are checks on local banks, not members of the Clearing House, which are received in the course of the day's business and collected directly from the drawee banks. If there is no Clearing House all local current checks come under this item.

CHECKS AND DRAFTS ON BANKS LOCATED OUTSIDE OF CITY

Banks make every effort to send out in the mail each day all checks and other items received during the day on out of town banks. Sometimes, however, such items are received too late to be forwarded, and are carried over until the following day before being sent out for collection, in which event they come under this head.

MISCELLANEOUS CASH ITEMS

Sometimes checks and other items are not charged immediately to the accounts against which they are drawn. Sometimes checks are returned to a bank, and for some reason it is not possible for the holding bank to make immediate collection. In such instances the items are carried as "Cash Items." The number and total amount of cash items

should never be large, for prompt collection should be made of them or, if the items are not good, they should be promptly charged off.

REDEMPTION FUND WITH U. S. TREASURER

and due from U. S. Treasurer

National Banks, when they have outstanding "circulating notes" are required to keep with the Treasurer of the United States a fund equal to 5% of the notes in circulation. As circulating notes are redeemed, from time to time, by the Treasurer they are charged to this account and the bank is notified, whereupon it must deposit an additional amount with the Treasurer so that the amount will equal 5% of the outstanding notes.

Banks often send to the Treasurer mutilated currency for redemption and new currency is sent by the Treasurer in exchange. In this event the amount is carried as "due from the U. S. Treasurer" until the new currency is received by the bank.

OTHER RESOURCES

Occasionally a bank will acquire an asset that cannot be properly classified under any one of the schedules shown by the statement, in which event it is carried as "Other Assets." This item should never show a very large amount, and is looked upon with considerable apprehension since it indicates an irregular item. If the bank's expenses have exceeded its earnings the "deficit" is usually carried under this item.

CAPITAL AND SURPLUS

The National Bank Act and the Banking Laws of the various states regulate the amount of capital a bank must have. Under the National Bank Act the minimum capital

a bank can have is \$25,000 while the minimum allowed under many state laws is \$10,000. In some instances the requisite capital is based on the population of the city or county in which the bank is located. In other states the requisite capital, after organization, is based on the average deposits of the bank over a definite period.

In many states, as is also the case in the organization of a National Bank, before a charter is granted the stockholders are required to pay in a surplus of 10%. This is indeed an excellent rule, for usually the first year's operation of the bank is not productive of profits and often there is a deficit in the earnings, which would impair the bank's capital and necessitate an assessment were it not for this paid-in surplus.

The capital represents the original investment of the stockholders, and the surplus, with the exception of that paid in, usually represents the amount of net earnings of the bank which have not been paid out in dividends to the stockholders. The National Bank Act and most State Banking Laws require the setting aside of a definite percentage of a bank's net earnings each year until its surplus equals a definite percentage of the bank's capital. Even after the bank has the surplus required by law, a good banker will continue to build up the surplus. A large surplus indicates strength. An individual who spends all he makes is looked upon by all good business men as doomed to ultimate failure. A bank that spends, by dividing among its stockholders all its earnings, is doomed to the same fate. A community is fortunate when it has a bank or banks with sufficient capital to take care of its business requirements and yet not too large to net a fair return, in the way of dividends, to its stockholders.

UNDIVIDED PROFITS

Undivided profits usually represent the earnings for a definite period out of which dividends are paid, surplus certified and reserves created. All earnings of a bank should go into this account before final distribution is made.

*"This account must be maintained in the general ledger and EVERY ENTRY, both debits and credits, must be explained and properly indentified by descriptive entry opposite each separate item. In other words, this account in the general ledger must speak for itself, by proper explanation of each entry."

CIRCULATING NOTES OUTSTANDING

As has already been set out, National Banks are permitted to issue their circulating notes "currency," which notes are the liability of the issuing bank. Before the passage of the National Bank Act of 1863 many state banks also issued currency. There are not now outstanding any State Banks circulating notes, for there is a tax of 10% on such circulating notes which makes such issues prohibitive. For the laws governing the issuing of circulating notes the National Bank Act and the Federal Reserve Act should be studied.

DEPOSITS

There are at least two classes interested in every bank—the stockholders and the depositors. The depositor class is by far the majority class both as to number and the amount involved. The minority class owns and controls the bank, through its directors, in its every policy, while the majority class has nothing to say concerning the management of the bank. There was on deposit March 31, 1924, in all banks in the United States a total of \$46,001,052,641. The num-

*"Rules and Regulations," Banking Department of Oregon.

ber of stockholders and number of depositors are not available, but the total invested in capital and surplus was \$6,726,443,398.

In gathering the idle funds of any community there are those which will be idle for different durations of time, there will be different people at different times who have idle funds, and so it is that a bank's average deposits are maintained. Then too there are different classes of deposits, viz., commercial, savings, time certificates, trust, etc., and the deposit of public funds. The prudent banker will use care at all times in investing (loaning) the deposits of his customers so that he may be able to liquidate a sufficient amount to take care of withdrawals at all times. Usually a banker had rather have several hundred medium size accounts than to have a very few large accounts, for in the first instance several depositors could withdraw their accounts at one time without embarrassment to the bank, but in the second instance one depositor might cause much embarrassment.

AMOUNT DUE TO NATIONAL BANKS AND AMOUNT DUE TO STATE BANKS, BANKERS, ETC.

These represent amounts due other banks, usually deposits made by other banks. If statement of city banks are studied it will be seen that often the total amount due other banks is a large percentage of the total deposits. Many of the city banks are "Reserve Agents" for country banks and therefore especially solicit deposits of other banks—this generally being a very desirable class of business.

CERTIFIED CHECKS

At times bank customers desire to have checks "certified." When a bank certifies a check it immediately

becomes a liability of the bank, and the amount should be charged to the customer's account and credited to "Certified Checks," and so carried until the check is paid. Checks should not be certified unless the customer has on deposit with the bank an amount sufficient to cover the check certified. In many states, as also under the National Bank Act, a bank is prohibited certifying a check unless the party has the amount on deposit.

Section 5208 of the National Bank Act provides: "It shall be unlawful for any officer, director, agent or employee—of any member bank—to certify any check drawn upon such member bank unless the person, firm or corporation drawing the check has on deposit with such member bank, at the time such check is certified, an amount of money not less than the amount specified in such check. Any check so certified by a duly authorized officer, director, agent, or employee, shall be a good and valid obligation against such member bank; but the act of any officer, director, agent, or employee of any such member bank in violation of this section shall subject such member bank, if a national bank, to the liabilities and proceedings on the part of the Comptroller of the Currency provided for in section 5234. Any officer, director, agent, or employee of any member bank who shall willfully violate the provisions of this section, or who shall resort to any device, or receive any fictitious obligation, directly or collaterally, in order to evade the provisions thereof, or who shall certify a check before the amount thereof shall have been regularly entered to the credit of the drawer upon the books of the bank, shall be deemed guilty of a misdemeanor, and shall, on conviction thereof in any district court of the United States, be fined not more than \$5,000, or shall be imprisoned for not more than five years, or both, in the discretion of the court."

BANK DIRECTORS

CASHIER'S CHECKS

These are checks drawn on a bank by itself and signed by some one of the officers authorized to sign for the bank. They are used for many purposes. In some instances they are used instead of drafts on other banks. Sometimes expense bills are paid with them, but more often these are paid with "expense checks" which in reality are officers' checks.

INDIVIDUAL DEPOSITS SUBJECT TO CHECK

This includes deposits of individuals, firms and corporations, exclusive of time deposits.

Men work and save and deposit their savings in banks. In every bank there are many depositors, possibly none of which have large deposits, yet in the aggregate they are much more useful than if they were not put together. Taken together they enable the bank to make loans to those who need money for carrying on business, and in this way the small savings of many serve the business needs of the community, and the farming needs of the surrounding territory. One function of banks is to gather the funds temporarily unemployed and lend them for short periods to those who can use them profitably.

STATE, COUNTY OR OTHER MUNICIPAL DEPOSITS

(Public Funds)

Banks are required to report this class of deposits separately. Often banks are required to pay interest on "public funds"; often such deposits are "let" on competitive bids, and at many times banks are required to give bonds guaranteeing such deposits, or are required to pledge certain assets as security for the deposit.

This class of deposits has caused bankers more worry than any other. Often they are surrounded by political

ties, and even when they are not many bankers have not realized the certainty of withdrawal, allowing themselves to place these funds out in such a manner that when the funds are called for they cannot be repaid, thus embarrassing the bank, and in some instances causing the closing of the bank.

DIVIDENDS UNPAID

Upon the declaration of a dividend the amount of the dividend is carried to this account. Dividend checks are issued to the stockholders and as they are returned to the bank they are paid and charged to this account.

DEMAND AND TIME DEPOSITS DEFINED

On account of the reserve requirements for banks which are members of the Federal Reserve System it is necessary to define "demand" and "time" deposits. Given here are the definitions as set out by the Federal Reserve Board:

*"DEMAND DEPOSITS—The term 'demand deposits' shall include all deposits which are payable within 30 days except 'savings accounts,' 'time certificates of deposit,' and 'postal savings deposits,' as defined below.

"TIME DEPOSITS—The term 'time deposits' shall include all 'time deposits, open accounts,' all 'savings accounts,' all 'time certificates of deposit' and all 'postal savings deposits,' as defined below.

"TIME DEPOSITS, OPEN ACCOUNTS—The term 'time deposits, open accounts' shall mean deposits not evidenced by certificates of deposit or savings pass books, in respect to which a written contract is entered into with the depositor at the time the deposit is made that neither the whole nor any part of such deposit may be withdrawn, by check or otherwise, except on a given date, not less than 30

*"Federal Reserve Board Regulations," Series of 1924.

days after the date of the deposit, or on written notice which must be given by the depositor a certain specified number of days in advance, in no case less than 30 days.

“SAVINGS ACCOUNTS—The term ‘savings accounts’ shall mean those deposits in respect to which—

(1) The pass book, certificate, or other similar form of receipt must be presented to the bank whenever a withdrawal is made;

(2) The depositor may at any time be required by the bank to give notice of any intended withdrawal not less than 30 days before a withdrawal is made; and

(3) The bank’s printed regulations, accepted by the depositor at the time the account is opened, include the above requirements.

“TIME CERTIFICATES OF DEPOSIT—A ‘time certificate of deposit’ is defined as an instrument evidencing the deposit with a bank, either with or without interest, of a certain sum specified on the face of the certificate payable in whole or in part to the depositor or on his order—

(1) On a certain date, specified on the certificate, not less than 30 days after the date of deposit; or

(2) After the lapse of a certain specified time subsequent to the date of the certificate, in no case less than 30 days; or

(3) Upon written notice, which the bank may at its option require to be given a certain specified number of days, not less than 30 days, before the date of repayment; and

(4) In all cases only upon representation of the certificate at each withdrawal for proper indorsement or surrender.

CERTIFICATES OF DEPOSIT

These are of two classes: (1) Demand Certificates and (2) Time Certificates, representing what the terms indi-

cate—money deposited for which the bank has issued its certificate payable either on demand upon the presentation of the certificate or payable at a fixed future date, usually 3, 6, 9 or 12 months after date of the certificate. Time certificates usually draw interest and are in the nature of a savings deposit, while demand certificates often state that they are payable on demand but if the deposit is left for three months or longer interest will be paid.

POSTAL SAVINGS DEPOSITS

*“The term ‘postal savings deposit’ shall mean deposits of postal savings funds in banks under the terms of the Postal Savings Act, approved June 25, 1910, as amended.”

UNITED STATES DEPOSITS

(Government Deposits)

†“The term ‘Government deposits’ shall mean deposits of public moneys by the United States in designated depositories.

“Deposits made by United States postmasters of Government funds, other than postal savings deposits, received by them in their official capacity, constitute ‘Government deposits’ within the meaning of this regulation and, when made in designated depositories, are exempt from reserve requirements of section 19.”

U. S. GOVERNMENT SECURITIES BORROWED AND BONDS AND SECURITIES BORROWED

At times, instead of purchasing bonds to secure circulating notes banks borrow these bonds from other banks. A bank may desire to use United States Government Bonds or other bonds and securities for a specific purpose for only

*“Federal Reserve Board Regulations,” Series of 1924.

†“Federal Reserve Board Regulations,” Series of 1924.

a temporary period and for this reason not desire to purchase the bonds. In either event the bonds may be borrowed, and the liability is carried as one of the above items.

BILLS PAYABLE

In the regular course of business, to take care of legitimate requirements of customers it is necessary for banks to borrow money. There is no reason why banks, like other business enterprises, should not borrow money. However, there is a clear distinction. Other lines of business often find that they can, by borrowing money, make a large return on the funds borrowed. Once in a while a banker is found who borrows money to re-loan for the profit he is able to make on the money borrowed, but this cannot be considered good banking practice. There is a clear distinction between borrowing to take care of the business requirements of a community, and borrowing for the profit there is in re-lending—just as clearly as there is a distinction between good and bad banking.

The most widely practiced method of borrowing is for a bank to execute its note and pledge as security its bills receivable or bonds and securities as collateral. Before the recent period of inflation and deflation, the customary margin of collateral was about 25%, however, during and since the depression much larger margins, and often collateral amounting to two or three times the amount borrowed, have been required. This large margin of collateral has been the exception and not the rule. The laws of some states prohibit a bank from pledging its assets in excess of $1\frac{1}{2}$ times the amount borrowed. Other states have no limit to the amount which a bank may pledge as security to its bills payable.

It seems strange, nevertheless it is true, that many people do not understand a bank, the same as an individual, may

at times lend all it cares to lend or all it is in position to lend. Many people think there is no limit to a bank's lending power and do not understand when they are told that the bank is making no new loans. Runs on banks have been caused on account of just such lack of knowledge. What a shame bankers have not taken more time and care to give such matters serious consideration, that the public may understand more fully this one fundamental of banking.

NOTES AND BILLS REDISCOUNTED

Frequently, instead of issuing its bills payable a bank will discount with another bank, usually one of its correspondents, some of its customers' notes. This method has become much more prevalent since the passage of the Federal Reserve Act and is growing in use. If these notes are sold without recourse there is no liability of the discounting bank, but if it endorses the notes with recourse there is a contingent liability which is shown as "notes and bills rediscounted."

LETTERS OF CREDIT AND TRAVELERS CHECKS SOLD FOR CASH

Commercial letters of credit and travelers' checks are often sold by banks. The former are used in financing the importation of goods and the latter are used by tourists as a convenient means for carrying funds.

RESERVE FOR INTEREST AND TAXES

Taxes, interest paid on deposits and other yearly charges accrue constantly. Just the exact amount of these items cannot be determined in advance and therefore, a bank should set aside a reserve for them. Some banks make an estimate at the end of the fiscal year of the amount of taxes,

interest and other charges which have accrued and set aside a reserve equal to these amounts. Other banks estimate these items in advance and set aside out of their earnings each month a part of the amounts so that at the end of the year the entire amount estimated has been set aside.

OTHER LIABILITIES

At times banks assume liabilities which do not properly come under any of the foregoing items. In such instances they are reported as other liabilities.

Thus has been set out in brief the usefulness of banks, a short discussion of their functions and an intimation of the duties of those who manage banking institutions. It should be remembered that defective policies in bank management are more dangerous than in any other form of business. Therefore it is of utmost importance that those entrusted with the management of banks and the direction of their policies should have a knowledge of sound business and banking principles.

Banks are a necessity for the carrying on of business and it is well known what part they have had in the industrial, commercial and agricultural development of our country and the entire world. It would be difficult to conceive conditions without banking institutions. Imagine if you can, the United States with no banks. Who would be willing to return to days of trade and barter?

Advancement means added responsibilities. Without those who are willing to assume responsibility, there can be no advancement. Should, then, those who are interested in development and progress hesitate to assume these duties?

Men labor and save and invest their savings in the community in which they live, and thus become prosperous. Were it not for their neighbors they could not do so. Then

has not the community a right to expect some additional service from those who are fitted to bear responsibility; who, through their business experience, have become successful and prosperous?

It is not intended to leave the impression that the duties of Bank Directors are so burdensome and the liabilities so grave that one dare not assume them. After all, successful banking depends on good business principles, and few banks so conducted ever have serious trouble. It is when selfishness, sentiment, speculation, or some other outside influence displaces good business judgment that trouble arises and disaster follows.

No one need shirk the duties, shun the responsibilities, nor fear the liabilities of a bank director if he will take enough active interest in his bank to see that it is conducted along sound business lines.

INDEX

A

- Acceptances discounted, 160.
- Advertising the banking business, 4.
- American Bankers Association educational plan, 5.
- Amounts due from other banks, 169.
- Amount due to banks, 174.
- Anderson, E. F., on causes of bank failures and their remedies, 46.
- Appearance of bank, 166.
- Appraisal of loans, 124.
- Appraisal of loans, form used for, 124.
- Approval of new loans, 68.
- Arkansas bank commissioner, 20.
- Auditing committee, 114.
- Audit by directors, 113.
- Audit, when to begin, 115.

B

- Balances due from banks and bankers, verification of, 137.
- Bank:
 - Cashiers underpaid, 20.
 - Commissioner of Arkansas, 35.
 - Crook, 53.
 - Examiners, 82.
 - Examinations not audits, 85, 86.
 - Examiners, meetings with directors, 86.
 - Failures, 78.
 - Failures, causes of, 38, 39.
 - Failures, their causes and remedies, 46.
 - Functions, 156.
 - Supervision in North Carolina, 77.
 - Wild cat, the, 56.
- Banks and bankers, criticism of, 6, 10.
- Banks:
 - Disastrous effect of failures, 2.
 - How differ from other business enterprises, 1.
 - Ignorance of public concerning, 4.
 - Number of national banks in United States, 3.
 - Number of state banks in United States, 3.
 - Total capital, surplus and profits, 1.
 - Total deposits, 1.
 - Total resources, 3.
 - Usefulness defined by Kansas Supreme Court, 2.
- Bankers:
 - County associations, 20.
 - Conventions, 20.
 - First duty, 8.
 - Ignorant and untrained, 55.
 - Relation to stockholders, 8.
 - Relation to depositors, 8.
- Banking:
 - Business confidential, 21.
 - Business typically American, 6.
 - Courses in schools, 5.
 - Departments, activities of, 81.
 - Departments, purposes and objects of, 75.

- House, 136, 164.
- Laws differ, 12.
- Rooms, 166.
- Basis of banking business is confidence, 23.
- Bills payable, 70, 143, 180.
- Bills payable, resolution authorizing, 144.
- Board, the ideal, 22.
- Bonds:
 - And securities, verification of, 126.
 - Borrowed, 179.
 - Fidelity, 147.
 - Other, 163.
 - Surety, 70.
- Books, when should be closed, 63.
- Borrowing, no restriction to, 52.
- Burglary insurance, 147.
- Business, periods of depression, 59.
- Business, order of, for monthly meetings, 67.

C

- Capital and surplus, total in banks in United States, 174.
- Capital requirements, 171.
- Capital, surplus and profits, total in banks in U. S., 1.
- Capital stock, 146.
- Cash book, teller's, 118.
- Cash, counting the, 116.
- Cash items, 117, 170.
- Cashier's checks register, 136.
- Cashier's checks, verification of, 136.
- Cashier's duties, 27.
- Cashier, qualifications of, 27.
- Cashiers underpaid, 35.
- Causes of bank failures, 38, 39.
- Causes of defalcations, 39.
- Certified checks, 175.
- Certified checks register, 136.
- Certified checks, verification of, 136.
- Certificates of deposit, 178.
- Certificates of deposit, register, 135.
- Certificates of deposit, verification of, 126.
- Charters for banks limited in some states, 88, 89.
- Checks on other banks in same city, 117, 170.
- Checks and drafts on banks located outside of city, 117, 170.
- Circulating notes outstanding, 163, 173.
- Clearing House, exchanges for, 170.
- Clerical work, condition of, 68.
- Closed banks, 76.
- Collection items, 116.
- Committee on Public Education, 4.
- Committees:
 - Examining, 114.
 - Executive, 66.
 - Finance, 66.
 - Loan and discount, 66.
 - Reports of, 68, 70.
- Comptroller of the Currency on bank failures, 38, 39.
- Conduct of officers, 29.
- Confidence, basis of banking business, 23.
- Conventions, bankers', 20.
- Counting the cash, 116.
- County bankers' associations, 20.
- Covey, Hon. J. D., dangers of a one-man bank, 30.
- Crissinger, Hon. D. R., letter on overdrafts, 159.
- Criticism of banks and bankers, 6, 10.
- Currency, 163.
- Customer's liability account of acceptances executed by the bank, 160.

D

- Dangers of a one-man bank, 30.
 - Defalcations, causes of, 39.
 - Defalcations, liability of directors for, 45.
 - Degree of diligence required of directors, 45.
 - Delegation of powers of directors, 23.
 - Demand deposits defined, 177.
 - Deposits:
 - Individual, 176.
 - Ledgers, the proving of, 118.
 - Protection of, 9.
 - Public, 50, 176.
 - Total in United States, 1, 173.
 - Depositors, banker's relation to, 8.
 - Directors:
 - An advisory board, 25.
 - Called "trustees," 14.
 - Cannot shirk duty and avoid liability, 101.
 - Chosen from all vocations, 16.
 - Contract for reasonable capacity, skill and care, 104.
 - Delegation of powers, 23.
 - Duty to know about officers and employees, 28.
 - Duties and powers, 44.
 - Election of, 17.
 - Liable for lack of administration, 107.
 - Liable to creditors and stockholders, 106.
 - Liability, 21.
 - Loans to, 69.
 - Meetings, 19, 66.
 - Meetings in connection with examinations, 86.
 - Minutes of meetings, 70.
 - Must be more than figure-heads, 100.
 - Must discharge their duty with care, 103.
 - Must know how their bank is being run, 104.
 - Not excused for ignorance, 16.
 - Not liable for bad judgment, 112.
 - Oath of, 14.
 - Powers of, 21, 24.
 - Required to act in good faith, 112.
 - Requirements to become, 15.
 - Responsible when they accept position as such, 102.
 - Selection of, 16.
 - Should assist officers, 26.
 - Use of funds of bank by, 56.
 - Why necessary, 13.
 - Distribution of loans, 64.
 - Dividends, 70.
 - Dividends unpaid, 177.
 - Due from banks and bankers, 137.
 - Due to banks, 174.
 - Duty, the banker's first, 8.
 - Duties assumed on becoming a bank director, 101.
 - Duties:
 - Of directors, 98.
 - Of directors concerning officers and employees, 28.
 - Of directors to exercise general supervision, 100.
 - Of directors to exercise supervision, 99.
- E
- Educational plan of American Bankers Association, 5.
 - Election of directors, 17.
 - Endorsements on interest, 121.
 - Endorsement on principal, 121.
 - Examining committee, 114.
 - Examinations, infrequent, 57.
 - Examinations of banks, 83.
 - Examinations, purposes of, 70.
 - Excessive loan limit, 52.

Exchanges for clearing house,
116, 170.

Executive committee, 66.

Expense, 146.

Expense account, 70.

Expense book, 146.

F

Failures, causes of, 38, 39.

Failures, disastrous effects of, 2.

Failure of directors to administer affairs of bank, 49.

Fidelity bonds, 147.

Finance committee, 66.

Financial statements, 125.

Agricultural form, 132, 133.

Manufacturers' form, 128, 129.

Merchants' form, 130, 131.

Stockmen's form, 134, 135.

Necessity of, 159.

Fractional silver, weights of, 116.

Functions of a bank, 156.

Furniture and fixtures, 136, 166.

G

Gold coins, weights of, 116.

Government deposits, 179.

H

Hun v. Cary, 15.

I

Ideal board of directors, 22.

Ignorant and untrained banker,
the, 55.

Inactivity of directors, 49.

Inadequate laws, 57.

Individual deposits, 176.

Insurance, burglary, 147.

Insurance, fire, 137.

Infrequent examinations, 57.

Interest endorsements, 121.

Interest, reserve for, 181.

Items in transit, 148.

J

Junior officers, 28.

K

Kane, Hon. T. P., 77.

Kansas Supreme Court defines
usefulness of banks, 2.

Kansas Supreme Court on disastrous effect of bank failures, 2.

Kniffin, W. K., Jr., on purposes
of bank examinations, 75.

L

Lawful reserve with Federal Reserve Bank, 168.

Laws, inadequate, 57.

Letters, proving the deposit, 118.

Letters of credit, 181.

Liabilities of directors, 21.

Liability of directors for:

Failure to attend board meetings, 111.

Failure to charge off worthless assets, 107.

Gross negligence, 45.

Cashiers' defalcations, 45.

Lack of administration, 107.

Lack of attention, 106.

Lack of supervision, 105.

Wrongful payment of dividend, 111.

Liability of directors to:

Creditors and stockholders, 106.

Depositors, 109, 110.

Stockholders, 108.

Liability ledger, 122.

Liabilities, other, 182.

Loans:

An excessive limit, 52.

Approval of new, 68.

Approval of, 122.

Distribution of, 64.

Examination of past due, 69.

To officers and directors, 69.

Loans:

- Special, 70.
- Loan committee, 66.
- Loans and discounts, 156, 158.
- Loans and discounts, proving of, 120.
- Lyon *v.* Corder *et al.*, 44.

M

- Managers of banks, the chief aim of, 65.
- Martin *v.* Challen, 113.
- McCulloch, Hon. Hugh, a letter to banks, 63.
- Meeting of directors in connection with examinations, 95.
- Meetings of directors, 19, 66.
- Meetings of stockholders, 17.
- Merrick, Hon. F. W., "The Personal Element in Bank Supervision," 90.
- Minutes of directors' meetings (sample form), 70.
- Minutes of stockholders' meetings (suggested form), 17.
- Mitchell, Hon. J. T., "Meetings of Directors in Connection with Examinations," 95.
- More than good will required of directors, 102.

N

- National banks:
 - Number in United States, 3.
 - Statement form, 157.
- New business, 68.
- New Hanover Grand Jury, 80.
- Notes and bills rediscounted, 181.
- North Carolina Corporation Commission, "Bank Supervision in North Carolina," 77.

O

- Oath of director, 14.

Officers:

- Conduct of, 29.
- Loans to, 69.
- Salaries of, 64.
- Should attend bankers' meetings, 27.
- Should furnish information to directors, 26.
- Use of funds of bank by, 56.
- Old business, 68.
- One-man bank, the, 47.
- One-man bank, dangers of a, 30.
- Order of business for monthly meeting, 67.
- Other banks, amounts due from, 137, 169.
- Other bonds, stocks and securities, 163.
- Other liabilities, 182.
- Other real estate, 136, 163.
- Other resources, 171.
- Overdrafts, 70.
- Overdrafts, proving the, 118.

P

- Past due loans, 123.
- Past due loans, examination of, 69.
- Peaveyhouse, Mr. W. W., "Cashiers Underpaid," 35.
- Periods of business depression, 59.
- Personnel of bank, 23.
- Personal element in bank supervision, 90.
- Policy in reference to new loans, 69.
- Postal savings deposits, 179.
- Powers of president, 27.
- Powers of directors, 21, 24, 44.
- Powers, delegation of, by directors, 23.
- Profits, undivided, 173.
- President, qualifications of, 27.
- President, powers of, 27.

Proving the deposit ledgers, 118.
 Proving the loans and discounts,
 120.
 Proving the overdrafts, 118.
 Protection of depositors, 9.
 Public funds, 50, 176.
 Public, ignorance concerning
 banks, 4.

R

Reading of minutes, 68.
 Reconciliation book, 138.
 Rediscouunts, 70, 143, 181.
 Redemption fund with U. S.
 Treasury, 171.
 Register for:
 Cashier's checks, 136.
 Certified checks, 136.
 Certificates of deposit, 135.
 Reports of committees, 68.
 Reports of president and cashier,
 68.
 Reserve with Federal Reserve
 Bank, 168.
 Reserve requirements, 169.
 Reserve for interest, 181.
 Reserve for taxes, 181.
 Resolution authorizing bills pay-
 able, 144.
 Resolution authorizing redis-
 counts, 145.
 Responsibilities of supervisors of
 banks, 75.
 Resources, total of all banks in
 United States, 3.

S

Salaries of cashiers, 36.
 Salaries of officers, 64.
Saturday Evening Post, an edi-
 torial, 6.
 Savings accounts, 178.
Schaake v. Dolley, 1.
 Schools of instruction for direc-
 tors, 20.

Securities, 126.
 Securities, U. S. and other bonds
 borrowed, 179.
 Selection of directors, 16.
 Silver dollars, weights of, 116.
 Special loans, 70.
 State banks, number in United
 States, 3.
 Stock certificates, 146.
 Stocks and securities, 17.
 Stockholders, banker's relations
 to, 8.
 Stockholders' meetings, 17.
 Stockholders' meetings, minutes
 of, 17.
 Statements, financial, 125.
 Statements, financial forms, 128,
 129, 130, 131, 132, 133, 134,
 135.
 Supervisor of banks, responsibili-
 ties of, 76.
 Surety bonds, 70.
 Surplus, 65, 171.

T

Taxes, reserve for, 181.
 Teller's cash book, 118.
 Time certificates of deposit, 178.
 Time certificates of deposit,
 proving of, 126.
 Time deposits defined, 177.
 Time deposits, open accounts,
 177.
 Travelers' checks, 181.

U

Undivided profits, 173.
 United States deposits, 179.
 United States government securi-
 ties, 163.
 United States government securi-
 ties borrowed, 179.
 Unpaid dividends, 177.
 Use of funds of bank by officers
 and directors, 56.

V

Verification of:
Balances due from banks,
137.
Bonds and securities, 126.
Cash, 116.
Cash items, 117.
Cashier's checks, 136.
Certified checks, 136.
Certificates of deposit, 126.

Deposit ledgers, 118.
Loans and discounts, 120.
Overdrafts, 118.

W

Wild cat bank, the, 56.
Weights of:
Gold coins, 116.
Fractional silver, 116.
Silver dollars, 116.

INDEX TO FORMS

	Form No.	Page
Appraisal of Loans and Discounts	4	124
Bonds and Securities	5	127
*Cashier's Check Register	11	136
*Certified Check Register	12	136
*Certificate of Deposit Register	10	135
*Distribution of Expense Book	18	146
Endorsement on Interest		121
Endorsement on Principal		121
Financial Statements:		
Agricultural	8 & 8A	132, 133
Manufacturers'	6 & 6A	128, 129
Merchants'	7 & 7A	130, 131
Stockmen's	9 & 9A	134, 135
*Liability Ledger	3	122
Minutes of Directors' Meetings		71
Minutes of Stockholders' Meetings		17
*National Bank Statement	18	157
Note	2	122
Order of Business for Directors' Meeting		67
*Reconcilement Book	13	138
Resolution Authorizing Bills Payable		144
Resolution Authorizing Rediscounts		145
Report of Examining Committee	17	148
Report of Examining Committee	17A	149
Report of Examining Committee	17B	150
Report of Examining Committee	17C	151
Report of Examining Committee	17D	152
Report of Examining Committee	17E	153
Report of Examining Committee	17F	154
Report of Examining Committee	17G	155
Stocks	5	127
*Teller's Cash Book	1	119
Verification of balances due from banks	14 & 14A	139, 140
Verification of balances due to banks	15 & 15A	141, 142
Verification of Items in Transit		143

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42
3009